2024 TRUST ADVISORS FORUM

HOT TOPICS IN ESTATE PLANNING

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HOT TOPICS IN ESTATE PLANNING

1) Current Tax Law – 2024 Updates

Much of the current individual and corporate tax law in the United States was created by the Tax Cuts and Jobs Act that was signed into law on December 22, 2017, and effective beginning January 1, 2018 (the "TCJA"). The TCJA has been widely heralded as a significate accomplishment by the Trump Administration and lauded by many in the wealthy and business classes who have largely benefited from higher transfer tax exemptions and lower income tax rates. Because the TCJA was passed using the Byrd Rule and in light of the national budget concerns attendant to major tax policy legislation, most of the individual tax reform provisions will sunset on December 31, 2025, which will bring many of the pre-TCJA rates and exemptions back into effect immediately on January 1, 2026. Many of the business tax reform provisions, however, were made permanent (or as permanent as legislation can be).

a) ***Income Tax***.

i) ***Taxation of Individuals***. The provisions of the TCJA significantly affected individual income taxation for wealthy clients. As many advisers have become acutely aware over the past decade, income tax planning has become more of a significant part of planning for clients and is considered more often when selecting and implementing estate planning strategies. Accordingly, a knowledge of income tax is important for all advisers, even for those whose roles have been traditionally limited to other areas, such as transfer taxes. A high-level summary of the current provisions impacting clients is included below.

(1) ***Income Tax Rates***. The TCJA significantly modified the income tax brackets for individuals. Most significantly, the TCJA reduced the highest tax rate to 37%. The income tax brackets for single individuals and married individuals filing jointly for 2024 are as follows:[2]

Single Individuals	
Amount of Income	**Tax Rate**
Not over $11,600	10%
Over $11,600 but not over $47,150	12%
Over $47,150 but not over $100,525	22%
Over $100,525 but not over $191,950	24%
Over $191,950 but not over $243,725	32%
Over $243,725 but not over $609,350	35%
Over $609,350	37%

[2] Rev. Proc. 2023-34, 2023-48 I.R.B. 1287.

Married Individuals Filing Jointly	
Amount of Income	**Tax Rate**
Not over $23,200	10%
Over $23,200 but not over $94,300	12%
Over $94,300 but not over $201,050	22%
Over $201,050 but not over $383,900	24%
Over $383,900 but not over $487,450	32%
Over $487,450 but not over $731,200	35%
Over $731,200	37%

(2) ***Capital Gains Rates***. The TCJA also altered the manner in which capital gains are taxed. Prior to the adoption of the TCJA, capital gains rates were determined based on a taxpayer's income tax bracket. Under the TCJA, however, capital gains rates are based on a taxpayer's income level. The capital gains rates for single individuals and married individuals filing jointly for 2024 are as follows:[3]

Single Individuals	
Amount of Income	**Tax Rate**
Not over $47,025	0%
Over $47,025 but not over $518,900	15%
Over $518,900	20%

Married Individuals Filing Jointly	
Amount of Income	**Tax Rate**
Not over $94,050	0%
Over $94,050 but not over $583,750	15%
Over $583,750	20%

(3) ***Standard Deduction***. The TCJA increased the standard deduction significantly in an effort to simplify the tax filing process for a majority of taxpayers. In 2024, the standard deduction under Code Section 63(c)(2) is $14,600 for a single individual and is $29,200 for married individuals filing jointly.[4] The increased standard deduction has resulted in more taxpayers taking the standard deduction rather than itemizing.[5]

(4) ***State and Local Tax Deduction***. The deduction for state and local taxes was reduced to $10,000 per taxpayer by the TCJA.[6] This limitation created significant challenges for taxpayers in high tax states and limited the ability to fully deduct local taxes. Note that this limitation does not apply to real and ***personal*** property taxes paid in carrying on a trade or business. The introduction of this limitation led to some states concocting schemes purported to allow taxpayers to contribute a portion of the taxpayer's local tax to a charitable fund established

[3] *Id.*
[4] *Id.*
[5] *See* Individual Income Tax Returns Complete Report 2018 (IRS Publication 1304 – Rev. 9-2020), 22, https://www.irs.gov/pub/irs-pdf/p1304.pdf#page=22. The 2018 tax report indicates that 87.3% of tax returns claimed a standard deduction in 2018—up from 68.9% in the prior year.
[6] 26 U.S.C.A. § 164(b)(6) (Westlaw through P.L. 116-258). This provision will sunset effective December 31, 2025.

by the state, for which the taxpayer would receive a credit for taxes paid and, purportedly, a federal income tax charitable deduction in lieu of the state and local income tax deduction.[7] A recent development regarding state and local taxes is that the IRS has indicated it intends to approve a more recent strategy introduced by a few states that enable a pass-through entity to elect to pay an entity-level state tax that results in an offsetting credit against the owners' individual income taxes.[8]

ii) ***Taxation of Business Entities***. Although the TCJA included many corporate provisions, two of the most discussed changes were as follows:

(1) ***Corporate Tax***. The TCJA lowered the corporate income tax to 21%, a significant change for corporate income taxes.

(2) ***Pass-Through Deduction***. The TCJA added Code Section 199A, which allows for a 20% deduction for certain pass-through entities.[9] The combination of the pass-through deduction and the lower corporate tax caused some clients to change the form of their business entity to take advantage of the new tax regime.

iii) ***Taxation of Estates and Trusts***. Trusts and estates are subject to quite unfavorable tax rates and a rather complex taxation scheme that resembles that of a pass-through entity in some regards. Trustees and advisers must carefully monitor the tax liability of estates and trusts and, when appropriate, seek to push taxable income out to the beneficiaries so that the income will be taxed at the beneficiary's rate, which is presumably lower than the rate that would otherwise apply if the income were taxed to the estate or trust. Although fiduciary income tax is not within the scope of this manuscript, the updated tax information for estate and trusts for 2023 is included below for easy reference for advisers tasked with the administration of estates and trusts.

(1) ***Income Tax Rates***. Estates and trusts are subject to an incredibly condensed tax bracket that results in the taxation of income at the highest rate with very modest income (significantly lower than the income required for a single individual or married individuals filing jointly). The 2024 income tax brackets for estates and trusts are as follows:[10]

Estates and Trusts	
Amount of Income	**Tax Rate**
Not over $3,100	10%
Over $3,100 but not over $11,150	24%
Over $11,150 but not over $15,200	35%
Over $15,200	37%

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[7] Treas. Reg. § 1.170A-1(h)(3) requires a taxpayer to reduce the value of a contribution to charity that results in a local tax credit or deduction, the value of the charitable contribution must be reduced by the amount of the credit or deduction (any such deduction or credit is a deemed quid pro quo benefit that negates the charitable deduction in the same manner as any return benefit received from a charitable entity).
[8] *See* I.R.S. Notice 2020-75, 2020-49 I.R.B. 1453.
[9] 26 U.S.C.A. § 199A (Westlaw through P.L. 116-258).
[10] Rev. Proc. 2022-38, 2022-45 I.R.B. 445.

(2) ***Capital Gains Rates***. The capital gains tax rates for estates and trusts for 2023 are as follows:[11]

Estates and Trusts	
Amount of Income	**Tax Rate**
Not over $3,150	0%
Over $3,150 but not over $15,450	15%
Over $15,450	20%

(3) ***Effect of Suspension of Miscellaneous Deductions***. The TCJA suspended miscellaneous itemized deductions (e.g., those subject to the 2% floor) for individuals for tax years beginning January 1, 2018, through December 31, 2025.[12] It was unclear whether this suspension applied to estates and trusts and whether a beneficiary could benefit from the distribution of excess deductions in the year of termination of an estate or trust. The IRS issued final regulations effective October 19, 2020, that address these issues, as briefly discussed below.[13]

(a) ***Code Section 67(g) does not apply to Estates and Trusts***. Treasury Regulation Section 1.67-4(a) was revised to provide that an estate or trust must compute its adjusted gross income in the same manner as an individual, except that the following Code Section 67(e) deductions are allowed in the calculation: (i) costs paid or incurred in connection with the administration of the estate or trust that would not have been incurred had the property not been held in an estate or trust; (ii) deductions allowed under Code Sections 642(b) (personal exemption), 651 and 661 (distributions). Further, a provision was added to provide that Code Section 67(e) deductions are not itemized deductions and are not miscellaneous itemized deductions under 67(e) and are therefore not suspended by Code Section 67(g).

(b) ***Excess Deductions Benefit Beneficiaries***. Code Section 642 provides that in the year of termination of an estate or trust, if there are certain excess deductions that exceed the taxable income of the estate or trust, then those excess deductions will pass to the beneficiary or beneficiaries who can in turn claim those deductions on their individual tax returns for the year in which the estate or trust terminated. The suspension of miscellaneous itemized deductions under Code Section 67(g) called into question whether beneficiaries may still receive a benefit from the excess deductions. Treasury Regulations Section 1.642(h)-2 was revised to provide as follows:[14]

(i) Excess deductions will pass to the beneficiary succeeding to the property of the estate or trust.

(ii) The character of the excess deduction retains its character in the hands of the beneficiary as it was in the hands of the estate or trust. Specifically, those deductions may be characterized as a deduction allowable in arriving at adjusted gross income, as a non-miscellaneous itemized deduction or as a miscellaneous itemized deduction (which is suspended for an individual under Code Section 67(g) until

[11] *Id*.
[12] 26 U.S.C.A. § 67(g) (Westlaw through P.L. 116-258).
[13] Final Treas. Reg. §§ 1.67-4(d), 1.642(h)-2(f) and 1.642(h)-5(c), 85 F.R. 66219 (Oct. 19, 2020).
[14] Treas. Reg. § 1.642(h)-2.

the tax year beginning January 1, 2026). Prior law treated these deductions as one single miscellaneous itemized deduction, which remains suspended until the tax year beginning January 1, 2026.

b) ***Transfer Taxes***. In addition to being concerned about income taxes, the ultra-wealthy are concerned with the transfer taxes under the Code—the estate tax, the gift tax and the generation-skipping tax. Each of these taxes is briefly discussed below.

i) ***Estate and Gift Tax***. The estate tax is levied on the estates of citizens of the United States, the estates of non-citizens who are residents of the United States and on United States assets owned by non-citizens who are residents of the United States. The estate tax is part of a unified transfer tax system that combines the estate and gift tax to tax both transfers during lifetime and at death (subject to certain deductions and credits). A full description of the unified estate and gift tax is beyond the scope of this manuscript. An update on the current basic exclusion amount that can be utilized for lifetime gifting or at death, the applicable tax rates and the gift tax annual exclusion are included below.

(1) ***Tax Rate***. The current maximum estate and gift tax rate is 40%.[15] This rate has fluctuated over the decades and was as high as 55% as recently as 2001.[16]

(2) ***Basic Exclusion Amount***. The basic exclusion amount is used to determine the applicable estate tax credit at death. Put simply, the basic exclusion amount is the value of assets that an individual may transfer during lifetime or at death without triggering gift or estate taxes. The basic exclusion amount has increased significantly throughout the past twenty-four years and, most recently, was doubled by the TCJA. The basic exclusion amount for 2023 is $13,610,000.[17] With portability, the total basic exclusion amount available to a married couple is $27,220,000. Note that the basic exclusion amount is scheduled to be reduced back to $5,000,000, as adjusted for inflation, according to the terms of the TCJA. A chart of the historical basic exclusion amount is included below.[18]

Year(s)	Basic Exclusion Amount
1997	$600,000
1998	$625,000
1999	$650,000
2000 – 2001	$675,000
2002 – 2003	$1,000,000
2004 – 2005	$1,500,000
2006 – 2008	$2,000,000
2009	$3,500,000
2010	$5,000,000 or $0
2011	$5,000,000

[15] 26 U.S.C.A. § 2001 (Westlaw through P.L. 116-258) and 26 U.S.C.A. § 2502 (Westlaw through P.L. 116-258).
[16] A Historical Look at Estate and Gift Tax Rates, 1 https://www.cch.com/press/news/historicalestategifttaxrates.pdf
[17] Rev. Proc. 2023-34, 2023-48 I.R.B. 1287.
[18] Rocky Mengle, Estate Tax Exemption Amount Goes Up for 2021, https://www.kiplinger.com/taxes/601639/estate-tax-exemption (last visited Jan. 12. 2021). Subsequently updated by authors.

Year(s)	Basic Exclusion Amount
2012	$5,120,000
2013	$5,250,000
2014	$5,340,000
2015	$5,430,000
2016	$5,450,000
2017	$5,490,000
2018	$11,180,000
2019	$11,400,000
2020	$11,580,000
2021	$11,700,000
2022	$12,060,000
2023	$12,920,000
2024	$13,610,000

(3) ***Gift tax annual exclusion amount***. Code Section 2503(b) provides that the first $10,000 in gifts to an individual shall be excluded from the determination of a donor's taxable gifts in a tax year (the "annual exclusion amount"). The annual exclusion amount is indexed for inflation.[19] The annual exclusion amount for 2024 is $18,000 per individual.[20] The annual exclusion amount will enable a married couple to gift a total of $36,000 to each donee without triggering a taxable gift that reduces each individual's lifetime gift tax exemption or requires the payment of gift tax.[21] Utilizing the annual exclusion amount in an annual gifting strategy can be very beneficial to wealthy clients attempting to reduce their taxable estates. Developing the habit of making annual exclusion gifts to descendants or other family members can transfer significant wealth over time, particularly when utilizing the split-gift election for a married couple. In addition, annual exclusion gifts remove the value of the gift and appreciation attributable to the gifted property from the donor's estate.

ii) ***Generation-Skipping Transfer Tax***. The generation-skipping transfer tax is imposed by Code Section 2601 on generation-skipping transfers. Although an analysis of the generation-skipping transfer tax can be complex, in its basic form, a generation-skipping transfer is a transfer from a donor to an individual occupying the generation of a donor's grandchild (a different calculation exists for unrelated individuals). The generation-skipping transfer tax is imposed at a flat rate of 40%.[22] Each individual has a generation-skipping exemption amount that is equal to the basic exclusion amount utilized for estate and gift tax purposes.[23] Therefore, an individual's generation-skipping transfer tax exemption is $13,610,000 in 2024.

[19] 26 U.S.C.A. § 2503(b)(2) (Westlaw through P.L. 116-258).
[20] Rev. Proc. 2023-34, 2023-48 I.R.B. 1287.
[21] Note, however, that a split-gift election of this nature requires the filing of a gift tax return for the year of the gift.
[22] 26 U.S.C.A. § 2641(a)(1) (Westlaw through P.L. 116-258) (providing that the applicable rate is calculated using the maximum federal estate tax rate).
[23] 26 U.S.C.A. § 2631(c) (Westlaw through P.L. 116-258).

c) ***Miscellaneous***.

i) ***Inflation Adjustments***. One change in the TCJA that did not garner much attention in the mainstream media but that has a significant impact on long term tax policy is the new method for calculating inflation adjustments. Specifically, the TCJA provided that inflation adjustments must now utilize the chained-CPI approach. The chained-CPI approach requires an inflation calculation that factors in a substitution effect in pricing goods. In the traditional calculation, the hypothetical basket of goods used to calculate inflation utilizes the same goods year over year—if the price of the specific goods increases, then there is inflation. Under the chained-CPI approach, if a good in a particular category becomes too expensive, it is assumed that consumers will substitute a cheaper good in the same category rather than continuing to purchase the exact same good at the higher price. Although this is perhaps a better method to analyze the spending habits of consumers, the chained-CPI approach will result in lower inflation rates and, more specifically, lower adjustments to income tax brackets, the basic exclusion amount, the annual exclusion amount and other tax items that are annually adjusted for inflation.

ii) ***Applicable Federal Rate***. The applicable federal rates ("AFRs"), which is often utilized in intra-family loans to avoid adverse income tax and gift tax issues, are at historical lows. As discussed below, this presents an opportunity for clients to provide significant benefits to family members without making a lifetime gift and can be quite helpful in certain transactions with trusts. The AFRs for February 2023 are as follows: the short-term AFR is 4.47%; the mid-term AFR is 3.82%; and the long-term AFR is 3.86%.[24]

iii) ***Code Section 7520 Rate***. The Code Section 7520 rate is utilized in calculating a remainder or reversionary interest—most often in determining the value of gifts in funding certain types of trusts. Like the AFR, the Code Section 7520 Rate is at a historic low, which presents a great opportunity for clients who are seeking to enter into lifetime transactions. The Code Section 7520 Rate for February 2023 is 4.6%.[25]

2) FY2024 Greenbook - Selected Provisions

a) Increase the corporate income tax rate from 21% to 28%

b) Increase the top marginal income tax rate from 37% to 39.6

c) Tax the capital income for high-income earners (taxable income over $1 million, $500,000 for married filing separately, both indexed) at ordinary rate

d) Increase the net investment income tax rate from 3.8% to 5.0% for taxpayers with more than $400,000 of earnings (indexed) (new in FY24 Greenbook) and apply the net investment income tax to pass-through business income for high income taxpayers (in the FY23 and FY24 Greenbooks)

[24] Rev. Rul. 2023-3, 2023-6 I.R.B. --.
[25] *Id*.

NOTE - The 39.6% top marginal income tax rate and the 5% net investment income tax rate bring the top marginal rate to 44.6%

e) Increase the Medicare tax would increase from 3.8% to 5.0% for taxpayers with more than$400,000 of earnings (indexed) (new in FY24 Greenbook)

f) Treat transfers of appreciated property by gift or on death as realization events; gain on unrealized appreciation also would be recognized by every trust, partnership or other non- corporate entity if the property has been held on or after January 1, 1942 and has not been the subject of a recognition event within 90 years; the FY24 Greenbook clarifies that the first such deemed recognition event would occur on December 31, 2032

g) Impose a 25% (up from 20% in the FY23 Greenbook) minimum tax on the income (generally including unrealized gains) on wealthiest taxpayers

h) Defined value formula clauses to determine the value of gifts or bequests that depend on some activity of the IRS will not be recognized, other than a formula clause defining a marital or exemption equivalent bequest at death based on the decedent's remaining transfer tax exclusion amount.

Reasons given for the proposal are (i) the clauses allow donors to escape gift taxes for undervaluing transfers, (ii) the clauses make gift tax return examinations and litigation cost-ineffective, (iii) transferred property must be reallocated among donees long after the gift, and (iv) the property rights of donees are determined in a tax valuation process in which they cannot participate.

The proposal is effective for transfers by gift or at death after 2023.

i) Simplify" the exclusion from gift tax for annual gifts; this proposal would limit the annual exclusion for many types of gifts to $50,000 per donor.

j) A purchase of assets from a GST non-exempt trust or any other property subject to GST tax would be treated as an addition to trust principal requiring a redetermination of the purchasing trust's inclusion ratio (by adding the purchased assets to the denominator of the applicable fraction).

k) Loans from a trust to a beneficiary will be treated as a distribution for GST tax purposes and a refund of GST tax paid as a result of such deemed distribution can be requested within one year after the loan is repaid in full; furthermore repayment of a loan to the grantor or deemed owner of a trust would be treated as a new contribution to the trust for GST tax purposes; the proposal applies to loans made, renegotiated, or renewed by trusts after the year of enactment

3) IRS Priority Guidance Plan – Gifts and Estates and Trusts

On September 29, 2023 the Treasury Department released is 2023-2024 Priority Guidance Plan. The following 10 items were listed under the heading “Gifts and Estates and Trusts”:

a) Regulations under §645 pertaining to the duration of an election to treat certain revocable trusts as part of an estate.

b) Final regulations under §§1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.

c) Regulations under §2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of § 20.2010-1(c). Proposed regulations were published on April 27, 2022.

d) Regulations under §2032(a) regarding imposition of restrictions on estate assets during the six-month alternate valuation period. Proposed regulations were published on November 18, 2011.

e) Final regulations under §2053 regarding the deductibility of certain interest expenses and amounts paid under a personal guarantee, certain substantiation requirements, and the applicability of present value concepts in determining the amount deductible. Proposed regulations were published on June 28, 2022.

f) Regulations under §20.2056A-2 for qualified domestic trust elections on estate tax returns, updating obsolete references.

g) Regulations under §2632 providing guidance governing the allocation of generation-skipping transfer (GST) exemption in the event the IRS grants relief under §2642(g), as well as addressing the definition of a GST trust under §2632(c), and providing ordering rules when GST exemption is allocated in excess of the transferor's remaining exemption.

h) Final regulations under §2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption. Proposed regulations were published on April 17, 2008.

i) Final regulations under §2801 regarding the tax imposed on U.S. citizens and residents who receive gifts or bequests from certain expatriates. Proposed regulations were published on September 10, 2015.

j) Regulations under §6011 identifying a transaction involving certain uses of charitable remainder annuity trusts as a listed transaction.

4) Corporate Transparency Act

In 2021, in a rare show of bipartisanship, Congress passed the Corporate Transparency Act (the "CTA"). The CTA is the result of many years of efforts by Congress, the Treasury, national security agencies, and law enforcement to put in place rules to ensure corporate transparency and stop money-laundering, terrorism, the proliferation of weapons of mass destruction, and other illicit activities. The CTA requires certain types of US and foreign entities to report information about their beneficial owners to the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN). The role of FinCEN is to protect the US financial system from crime and illicit use and

the reporting requirements are intended to provide information to FinCEN that will allow it to monitor activity within the US financial system in order to ferret out bad actors.

Following enactment of the CTA in 2021, on September 29, 2022, FinCEN issued a Final Rule establishing the beneficial ownership information reporting requirements as mandated by the Corporate Transparency Act. The Final Rule is one of three rulemakings planned to implement the Corporate Transparency Act.[26]

The Final Rule became effective on January 1, 2024. The Final Rule is located at 31 CFR 1010 and the document citation is 87 FR 59498.[27]

While the objectives and purpose of the Beneficial Ownership Reporting requirements under the CTA and the Final Rule are laudable, the entities affected by these requirements are much broader than many of us may assume. Example: How many of us believe our elderly clients who are placing their family beach house in an LLC are actively involved in the proliferation of weapons of mass destruction? Is our elderly farmer client who is placing his farm in an LLC for inheritance purposes guilty of terrorism? Highly unlikely. Indeed, totally improbable. Yet the LLCs in these two examples as well as many other entities that we, as estate planners, create for clients will be subject to the new reporting requirements. Thus, understanding the reporting requirements is critical as we will have to advise our clients regarding when and what they will need to report to FinCEN.

a) ***Application of Final Rule—Who is Impacted***. The Final Rule requires certain entities ("reporting companies") to file reports with FinCEN that provide two categories of information: (i) the identity of all beneficial owners of the company, and (ii) the identity of all individuals who participated in filing an application with specified governmental authorities to create the entity or register it to do business.

b) ***Definition of a Reporting Company***. A reporting company is defined based on the following:

i) A reporting company can be a domestic or a foreign entity including a corporation and a limited liability company.[28]

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[26] Note that a second part of the implementation of the Corporate Transparency Act was the issuance of rules establishing who may access beneficial ownership information, for what purposes, and what safeguards will be required to ensure that the information is secured and protected. On December 15, 2022, FinCEN issued proposed guidance on who would have access to the beneficial ownership information reported to FinCEN. See https://www.fincen.gov/news/news-releases/fincen-issues-notice-proposed-rulemaking-regarding-access-beneficial-ownership.

[27] The authority citation for part 1010 is as follows: Authority: 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314, 5316-5336; title III, sec. 314 Pub. L. 107-56, 115 Stat. 307; sec. 701 Pub. L. 114-74, 129 Stat. 599; sec. 6403, Pub. L. 116-283, 134 Stat. 3388.

[28] Regs. §1010.380(c)(1).

ii) A reporting company is essentially any entity that is created by the filing of a document with a secretary of state.[29] This is an incredibly broad definition and was intentionally drafted in this manner.

iii) Trusts are not reporting companies—this is a big exception. Note, however, that this does not mean that trusts are not impacted by the reporting requirements. If a trust is a beneficial owner of a reporting company under the rules, it must provide the requisite information to enable the reporting company to satisfy the reporting requirements.

iv) A list of all of the exceptions is as follows:[30]

(1) ***Securities reporting issuer***. Any issuer of securities that is: (A) An issuer of a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l); or (B) Required to file supplementary and periodic information under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)).

(2) ***Governmental authority***. Any entity that: (A) Is established under the laws of the United States, an Indian tribe, a State, or a political subdivision of a State, or under an interstate compact between two or more States; and (B) Exercises governmental authority on behalf of the United States or any such Indian tribe, State, or political subdivision.

(3) ***Bank***. Any bank, as defined in: (A) Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813); (B) Section 2(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)); or (C) Section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)).

(4) ***Credit Union***. Any Federal credit union or State credit union, as those terms are defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752).

(5) ***Depository institution holding company***. Any bank holding company as defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841), or any savings and loan holding company as defined in section 10(a) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)).

(6) ***Money services business***. Any money transmitting business registered with FinCEN under 31 U.S.C. 5330, and any money services business registered with FinCEN under 31 CFR 1022.380.

(7) ***Broker or dealer in securities***. Any broker or dealer, as those terms are defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c), that is registered under section 15 of that Act (15 U.S.C. 78o).

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[29] *Id.*

[30] Regs. §1010.380(c)(2).

(8) ***Securities exchange or clearing agency***. Any exchange or clearing agency, as those terms are defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c), that is registered under sections 6 or 17A of that Act (15 U.S.C. 78f, 78q-1).

(9) ***Other Exchange Act registered entity***. Any other entity not described in paragraph (c)(2)(i), (vii), or (viii) of this section that is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(10) ***Investment company or investment adviser***. Any entity that is: (A) An investment company as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), or is an investment adviser as defined in section 202 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2); and (B) Registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) or the Investment [*59594] Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.).

(11) ***Venture capital fund adviser***. Any investment adviser that: (A) Is described in section 203(l) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(l)); and (B) Has filed Item 10, Schedule A, and Schedule B of Part 1A of Form ADV, or any successor thereto, with the Securities and Exchange Commission.

(12) ***Insurance company***. Any insurance company as defined in section 2 of the Investment Company Act of 1940 (15 U.S.C. 80a-2).

(13) ***State-licensed insurance producer***. Any entity that: (A) Is an insurance producer that is authorized by a State and subject to supervision by the insurance commissioner or a similar official or agency of a State; and (B) Has an operating presence at a physical office within the United States.

(14) ***Commodity Exchange Act registered entity***. Any entity that: (A) Is a registered entity as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a); or (B) Is: (1) A futures commission merchant, introducing broker, swap dealer, major swap participant, commodity pool operator, or commodity trading advisor, each as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a), or a retail foreign exchange dealer as described in section 2(c)(2)(B) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(B); and (2) Registered with the Commodity Futures Trading Commission under the Commodity Exchange Act.

(15) ***Accounting firm***. Any public accounting firm registered in accordance with section 102 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7212).

(16) ***Public utility***. Any entity that is a regulated public utility as defined in 26 U.S.C. 7701(a)(33)(A) that provides telecommunications services, electrical power, natural gas, or water and sewer services within the United States.

(17) ***Financial market utility***. Any financial market utility designated by the Financial Stability Oversight Council under section 804 of the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5463).

(18) ***Pooled investment vehicle***. Any pooled investment vehicle that is operated or advised by a person described in paragraph (c)(2)(iii), (iv), (vii), (x), or (xi) of this section.

(19) ***Tax-exempt entity***. Any entity that is: (A) An organization that is described in section 501(c) of the Internal Revenue Code of 1986 (Code) (determined without regard to section 508(a) of the Code) and exempt from tax under section 501(a) of the Code, except that in the case of any such organization that ceases to be described in section 501(c) and exempt from tax under section 501(a), such organization shall be considered to continue to be described in this paragraph (c)(1)(xix)(A) for the 180-day period beginning on the date of the loss of such tax-exempt status; (B) A political organization, as defined in section 527(e)(1) of the Code, that is exempt from tax under section 527(a) of the Code; or (C) A trust described in paragraph (1) or (2) of section 4947(a) of the Code.

(20) ***Entity assisting a tax-exempt entity***. Any entity that: (A) Operates exclusively to provide financial assistance to, or hold governance rights over, any entity described in paragraph (c)(2)(xix) of this section; (B) Is a United States person; (C) Is beneficially owned or controlled exclusively by one or more United States persons that are United States citizens or lawfully admitted for permanent residence; and (D) Derives at least a majority of its funding or revenue from one or more United States persons that are United States citizens or lawfully admitted for permanent residence.

(21) ***Large operating company***. Any entity that: (A) Employs more than 20 full time employees in the United States, with "full time employee in the United States" having the meaning provided in 26 CFR 54.4980H-1(a) and 54.4980H-3, except that the term "United States" as used in 26 CFR 54.4980H-1(a) and 54.4980H-3 has the meaning provided in § 1010.100(hhh); (B) Has an operating presence at a physical office within the United States; and (C) Filed a Federal income tax or information return in the United States for the previous year demonstrating more than $5,000,000 in gross receipts or sales, as reported as gross receipts or sales (net of returns and allowances) on the entity's IRS Form 1120, consolidated IRS Form 1120, IRS Form 1120-S, IRS Form 1065, or other applicable IRS form, excluding gross receipts or sales from sources outside the United States, as determined under Federal income tax principles. For an entity that is part of an affiliated group of corporations within the meaning of 26 U.S.C. 1504 that filed a consolidated return, the applicable amount shall be the amount reported on the consolidated return for such group.

(22) ***Subsidiary of certain exempt entities***. Any entity whose ownership interests are controlled or wholly owned, directly or indirectly, by one or more entities described in (1), (2), (3), (4), (5), (7), (8), (9), (10), (11), (12), (13), (14), (15), (16), (17), (19), or (21) above.

(23) ***Inactive entity***. Any entity that: (A) Was in existence on or before January 1, 2020; (B) Is not engaged in active business; (C) Is not owned by a foreign person, whether directly or indirectly, wholly or partially; (D) Has not experienced any change in ownership in the preceding twelve month period; (E) Has not sent or received any funds in an amount greater than $1,000, either directly or through any financial account in which the entity or any affiliate of the entity had an interest, in the preceding twelve month period; and (F) Does not

otherwise hold any kind or type of assets, whether in the United States or abroad, including any ownership interest in any corporation, limited liability company, or other similar entity.

c) ***Initial Report***. Reporting companies are required to file an initial report with FinCEN. The initial report must include the information noted below.

i) The initial report must include the following information for the reporting company:[31]

(1) Full legal name;

(2) Any trade name or DBA;

(3) A complete current address which must be the principal place of administration for a business in US. If the business is a non-US business, the address must be the primary location in the US where business will be conducted; and

(4) The EIN/TIN for the company.

ii) The initial report must include the following information for each beneficial owner:[32]

(1) Full legal name;

(2) Date of birth;

(3) Complete current residential address;

(4) Unique ID document information (e.g., passport, non-expired document from state or local government, non-expired driver's license); and

(5) A copy of the ID document.

iii) The initial report must include the following information for the company applicant:[33]

(1) Full legal name;

(2) Date of birth;

(3) Address of business where the applicant works;

(4) Unique ID information and copy of that document.

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[31] Regs. §1010.380(b)(i).
[32] Regs. §1010.380(b)(ii).
[33] *Id*.

iv) ***Note***: A reporting company and any beneficiary owner can each submit an application with the information above in order to obtain a FinCEN identifier.[34] If a FinCEN identifier is obtained, the reporting company may include such FinCEN identifier in the report in lieu of the information required above.[35]

d) ***Beneficial Owners***. Beneficial owners are defined as described below.[36]

i) Any individual who directly or indirectly exercises substantial control over a reporting company. Substantial control is defined as an individual who:[37]

(1) Serves as a senior officer;

(2) Has authority over the appointment or removal of any senior officer or a majority of the board;

(3) Directs or has substantial influence over important decisions made by the reporting company (includes decisions related to nature, scope and attributes of the business of the company, dissolution merger, reorganization, major expenditures or investments, etc.); or

(4) Any other form of substantial control.

> ***Note***: "an individual may directly or indirectly, including as trustee of a trust or similar arrangement, exercise substantial control over a reporting company through board representation, ownership or control of a majority of the voting owner or voting rights of the company, rights associated with any financial arrangement or interest in a company, control over one or more intermediary entities that separately exercise substantial control over the reporting company, etc."

ii) Any individual who directly or indirectly owns or controls at least 25% of the ownership interests in a reporting company

(1) This definition includes capital or profits interests, put call straddles, etc. in calculating ownership percentages.

(2) An individual can directly or indirectly own a company through any contract, relationship, etc. including joint ownership; through another individual acting as a nominee or agent; through a trust or similar arrangement that holds such ownership interest, in either the role

[34] Regs. §1010.380(a)(4).
[35] Regs. §1010.380(a)(4)(ii)(A).
[36] Regs. §1010.380(d).
[37] Regs. §1010.380(d)(1).

(a) as a trustee of a trust or other individual with the authority to dispose of trust assets, or

(b) as a beneficiary who is the sole permissible recipient of income and principal from the trust or who has the right to demand a distribution of or withdraw substantially all of the assets from the trust, or

(c) as a grantor who has the right to revoke the trust.

iii) ***Exceptions***. There are five exceptions to the definition of beneficial owner. The following individuals are not considered to be beneficial owners:

(1) Minor children (but only while minors);

(2) Individuals acting as a nominee, custodian or agent for another individual;

(3) Employees of reporting companies;

(4) An individual whose only interest in a reporting company is a future interest through right of inheritance; and

(5) A creditor of a reporting company.

e) ***Company Applicants***. The CTA defines a "company applicant" for purposes of the reporting requirements as:[38]

i) An individual who directly files a document to create (with respect to a domestic reporting company) or first register (with respect to a foreign reporting company) a reporting company with a Secretary of State or similar office of a state, and

ii) The individual who is primarily responsible for directing or controlling the individual to file the document.

The Final Disclosure Regulations thus envision that a reporting company will have no more than two company applicants. One can easily envision lawyers and their staff (e.g., associate, paralegal, legal assistant), who regularly assist clients with the formation of entities, falling within the definition of "company applicant."

f) ***FinCEN Identifier***. In lieu of providing the information described above for each reporting company report, an individual or company may obtain a FinCEN identifier by submitting the information required in the initial report.[39] An individual who is required to be listed as a company applicant or a beneficial owner on a reporting company's initial report may provide the individual FinCEN Identifier to the reporting company instead of the information described above for use in the report.[40] If the information reported to obtain the FinCEN identifier

[38] Regs. §1010.380(e).
[39] Regs. §1010.380(a)(4)(i).
[40] Reg. §1010.380(a)(4)(ii)(A).

changes, the individual must update the information within 30 calendar days of the date the information changed.[41]

g) ***Effective Dates and Reporting Requirements***.

i) The Final Rule took effect January 1, 2024. Thus, starting on January 1, 2024, all reporting companies must begin providing this information to FinCEN.

ii) For existing reporting companies, the report must be filed by January 1, 2025. This means that every single reporting company in existence on 1/1/24 has a year to file the initial report. Identifying all of those companies will be difficult.

iii) Any domestic reporting company created on or after January 1, 2024, and before January 1, 2025, is required to file the initial report within ninety calendar days of creation.[42]

iv) Any domestic reporting company created on or after January 1, 2025, is required to file the initial report within thirty calendar days of creation.[43]

v) Any foreign entity that becomes a foreign reporting company on or after January 1, 2024, and before January 1, 2025, shall file a report within ninety days of the earlier of the date on which it receives notice that it has been registered to do business or on the date which a secretary of state or similar office first provides public notice that the foreign reporting company has been registered to do business.[44]

vi) Any foreign entity that becomes a foreign reporting company on or after January 1, 2025, shall file a report within thirty days of the earlier of the date on which it receives notice that it has been registered to do business or on the date which a secretary of state or similar office first provides public notice that the foreign reporting company has been registered to do business.[45]

vii) If a company initially was exempt from the reporting requirements, but subsequently loses that exemption—the company has 30 days to file the initial report.[46]

viii) One exception as to information required to be reported: for companies in existence on 1/1/24, information on company applicant doesn't need to be reported.

h) ***Requirement to Update Initial Report Information***. Changes to the information required to be provided in the Initial Report must be updated in a new report within 30 days after the date on which the change occurs. The new report must contain all of the required

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[41] Reg. §1010.380(a)(4)(iii)(A).
[42] Reg. §1010380(a)(1)(i)(A).
[43] Reg. §1010380(a)(1)(i)(B).
[44] Reg. §1010380(a)(1)(ii)(A).
[45] Reg. §1010380(a)(1)(ii)(B).
[46] Reg. §1010380(a)(1)(iv).

information listed above for any new beneficial owner or applicant. Events that constitute a change that would trigger an additional reporting requirement include:[47]

i) When an individual acquires an interest in the company and that individual satisfies the "beneficial owner" definition

ii) The death of a beneficial owner

(1) Specifically, the Final Rule state that a change triggering an additional reporting requirement occurs "when the estate of the deceased beneficial owner is settled, either through the operation of the intestacy laws or through a testamentary deposition."

iii) When a minor attains age of majority

iv) When information that is contained on an ID document that was required to be provided to FinCEN changes.

(1) If the person's name on the ID document changes, an update is required.

(2) If the person's address or ID number changes, an update is required.

i) ***Disclosure of Beneficial Ownership Information***. FinCEN issued final regulations regarding the disclosure of beneficial ownership information ("BOI") to federal and state agencies on December 21, 2023.[48] The final regulations provided access to authorized recipients as briefly described below.[49] In addition, the final regulations evidence an effort to keep BOI confidential while also ensuring the appropriate agencies have access to the information to further the purposes the CTA by enabling the appropriate authorities to gain access to BOI. Notably, each recipient is subject to specific security and confidentiality requirements.

i) ***Disclosure to federal agencies***. Upon request from a federal agency engaged in national security, intelligence or law enforcement activity, FinCEN may provide BOI to the agency if the agency's activity is in furtherance of its national security, intelligence or law enforcement activity.[50] Law enforcement activity in this context includes investigative and enforcement activities related to both civil and criminal violations of the law.

ii) ***Disclosure to state, local and tribal law agencies***. FinCEN may provide BOI upon request to a state, local or tribal law enforcement agency for BOI to be used in a civil or criminal investigation provided that a court of competent jurisdiction has authorized the agency to seek the requested information.[51]

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[47] Reg. §1010.380(a)(2).
[48] Reg. §1010.955
[49] *Id*.
[50] Regs. §1010.955(b)(1).
[51] Regs. §1010.955(b)(2).

iii) ***Disclosure for use in foreign national security, intelligence or law enforcement activity***. FinCEN may disclose BOI to a federal agency for the purpose of sharing the BOI with a foreign enforcement agency, prosecutor, or judge under an applicable international treaty, agreement or convention, provided that (A) the request is for assistance with a law enforcement investigation or prosecution or for a national security or intelligence activity that is authorized under the laws of the foreign country, and (B) the request is made under an international treaty, agreement or convention or, when no such agreement is available, made as an official request by a law enforcement, judicial or prosecutorial authority determined by FinCEN, in consultation with the Secretary of State, Attorney General and other applicable agencies, to be a trusted foreign country.[52]

iv) ***Disclosure to financial institutions subject to customer due diligence requirements***. FinCEN can disclose BOI to a financial institution for the purpose of enabling it to comply with applicable customer due diligence requirements provided that the reporting company has consented to the provision of the information.[53]

v) ***Disclosure to regulatory agencies***. FinCEN may disclose BOI to a federal regulator or other appropriate regulatory agency to ensure a financial institution has complied with its customer due diligence requirements if the agency (A) is authorized by law to access, supervise, enforce or otherwise determine the compliance of the financial institution with customer due diligence requirements, (B) will use the information solely for the purpose of conducting the assessment, supervision or authorized investigation or activity, and (C) has entered into an agreement with FinCEN providing for appropriate safekeeping protocols for the BOI.[54]

vi) ***Disclosure to Treasury personnel***. FinCEN may disclose information to any Treasury officer or employee whose official duties require BOI inspection or disclosure or for tax administration.[55]

vii) ***Redisclosure by Authorized Recipients***. Authorized recipients of BOI are generally prohibited from sharing BOI.[56] Examples of authorized sharing include an authorized entity sharing the BOI with the employees and officers of that entity to fulfill the purpose of the request and sharing the BOI with a court of competent jurisdiction for law enforcement purposes.[57]

j) ***Violations and Penalties***. The CTA provides penalties for failing to comply with the CTA's provisions as described below:

i) ***Reporting Violations***. It is unlawful for any person to (A) willfully provided, or attempt to provide, false or fraudulent beneficial ownership information, including a false or fraudulent identifying photograph or document, to FinCEN or (B) willfully fail to report

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[52] Regs. §1010.955(b)(3).
[53] Regs. §1010.955(b)(4)(1).
[54] Regs. §1010.955(b)(4)(ii).
[55] Regs. §1010.955(b)(5).
[56] Regs. §1010.955(c)(2).
[57] *Id*.

complete or updated beneficial ownership information to FinCEN.[58] A person found to have violated these rules (A) shall be liable to the United States for a civil penalty of not more than $500 per day that the violation continues or has not been remedied and (B) may be fined no more than $10,000, imprisoned for not more than two years or both.[59] The CTA includes a safe harbor that provides that a person will not be subject to the civil and criminal penalties if the person has reason to believe that the information was inaccurate and voluntarily and promptly (less than ninety days) submits a corrected report.[60] A person, however, shall not qualify for the safe harbor if the person acted with the purpose of evading the reporting requirements and has actual knowledge that the information included in the report was inaccurate.[61]

ii) ***Unauthorized Disclosure or Use***. Except as authorized by the CTA and the accompanying regulations, it is unlawful for any person to knowingly disclose or knowingly use the BOI obtained by the person through (A) a report submitted to FinCEN or (B) a disclosure made by FinCEN.[62] A person found to have violated these rules (A) shall be liable to the United States for a civil penalty of not more than $500 per day that the violation continues or has not been remedied and (B) (i) shall be fined not more than $250,000 or imprisoned for not more than five years, or both, or (ii) while violating another law of the United States or as a part of a pattern of any illegal activity involving more than $100,000 in a twelve-month period, shall be fined not more than $500,000, imprisoned for not more than ten years, or both.

5) Cryptocurrency and NFT Issues

a) *CCA 202302012*

In January 2023, the IRS published Chief Counsel Advice 202302012, which advised that a taxpayer is required to obtain a qualified appraisal under Code Section 170(f)(11)(C) for contributions of cryptocurrency for which the taxpayer claims a charitable contribution deduction of more than $5,000.

The facts presented involved a taxpayer who purchased crypto through a crypto exchange. The taxpayer later transferred her crypto to a charitable organization described in Code Section 170(c). The taxpayer completed Part I, Section B of Form 8283 and attached it to her federal income tax return to claim a charitable contribution deduction of $10,000. The taxpayer did not obtain (nor attempted to obtain) a qualified appraisal of the donation.

In general, under Code Section 170(f), for contributions of property for which a deduction of more than $5,000 is claimed, the taxpayer must obtain a qualified appraisal to satisfy certain substantiation requirements. An exception to the qualified appraisal requirement is donations of certain readily valued property specifically set forth in the Code and regulations (e.g., cash, stock in trade, publicly traded securities, etc.). Further, a failure to meet the substantiation

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[58] 31 U.S.C. 5336(h)(1).
[59] 31 U.S.C. 5336(h)(3)(A).
[60] 31 U.S.C. 5336(h)(3)(C)(i)(I).
[61] 31 U.S.C. 5336(h)(3)(C)(i)(II).
[62] 31 U.S.C. 5336(h)(2).

requirements does not result in a denial of the deduction if the failure is due to reasonable cause and not to willful neglect.

Here, the IRS found that no exception to the qualified appraisal requirements of Code Section 170(f)(11) applies. Crypto is not cash, a publicly traded security, or any other excepted property. Further, the IRS ruled that the reasonable cause exception did not apply because the taxpayer did not try to obtain an appraisal. Therefore, the taxpayer's deduction was disallowed.

b) ***CCA 202302011***

In January 2023, the IRS published Chief Counsel Advice 202302011, which advised that if a taxpayer owns crypto that has substantially declined in value, the taxpayer has not sustained a loss under section 165 of the Code.

The facts presented involved a taxpayer who purchased crypto in 2022 at $1.00 per unit for personal investment purposes through a crypto exchange. By the end of 2022, the per unit value decreased to less than one cent ($0.01). Despite the decrease in value, the crypto was still traded on the exchange, and the taxpayer maintained dominion and control over his units. The taxpayer claimed a deduction on his 2022 tax return under Code Section 165 and took the position that the units of crypto were either worthless or abandoned.

Code Section 165 provides a deduction for losses sustained during a taxable year and not compensated for by insurance or otherwise. Whether an asset has become worthless is a question of fact. Also of note is that under the regulations (section 1.165-2(a)) a taxpayer sustains a loss under section 165 due to abandonment if (1) the loss is incurred in a transaction entered into for profit; (2) the loss arises from a sudden termination of usefulness; and (3) the property is permanently discarded from use.

Here, the IRS found that Code Section 165 did not apply to these facts because the crypto was still traded on the exchange and could increase in value in the future. Moreover, the taxpayer did not abandon his units of crypto because he maintained ownership of it.

c) ***CCA 202316008***

In March 2023, the IRS published Chief Counsel Advice 202316008, which advised that a taxpayer does not realize gain or loss under section 1001 of the Code and does not have an item of gross income under section 61(a) as a result of a protocol upgrade to a distributed ledger to which the taxpayer's crypto belongs. Here, the taxpayer owned crypto that was native to a blockchain that changed its mechanism for validating transactions (i.e., a protocol upgrade). The taxpayer's crypto units, stored in an unhosted wallet, did not change hands because of the protocol upgrade. Accordingly, because the taxpayer's units of crypto remained unchanged, he did not realize a gain or loss under section 1001 as a result of the protocol upgrade.

d) ***Notice 2023-27***

Notice 2023-27 announces that the Department of the Treasury and the IRS intend to issue guidance related to certain non-fungible tokens (NFTs) as collectibles under Code Section 408(m) of the Code.

According to the Notice, "[a]n NFT is a unique digital identifier that is recorded using distributed ledger technology and may be used to certify authenticity and ownership of an associated right or asset." An NFT can certify ownership of a "digital file" or an asset that is not a digital file (such as the right to attend a ticketed event).

Code Section 408(m)(2) defines "collectible" as any (i) work of art; (ii) rug or antique; (iii) metal or gem; (iv) stamp or coin; (v) alcoholic beverage; or (vi) other tangible personal property specified by the Secretary for purposes of this subsection. Code Section 408(m)(1) provides that the acquisition by an IRA of a collectible is treated as a distribution from the IRA equal to the cost to the IRA of the collectible.

Here, the Treasury and the IRS intend to use a "look-through" analysis to determine whether an NFT is a Code Section 408(m) collectible. For example, an NFT that certifies ownership of a gem is a Code Section 408(m) collectible. In contrast, an NFT that provides the right to develop a plot of land in a virtual environment generally is not a Code Section 408(m) collectible. The Notice concludes by requesting comments.

6) Code Section 2053 Cases

a) ***Estate of Spizzirri v. Commissioner, T.C. Memo 2023-25 (Feb. 28, 2023).***

Estate of Spizzirri v. Commissioner addressed whether payments made by Decedent's Estate pursuant to the terms of his prenuptial agreement were deductible as claims against the Estate under Code Section 2053 and whether lifetime payments to friends and family were gifts or compensation for services rendered.

Decedent died married to his fourth wife with whom he had entered a prenuptial agreement, which they subsequently amended multiple times during the marriage. The prenuptial agreement required that Decedent's estate plan would provide specific bequests of $1 million to each of wife's children and wife would receive the right to reside in one of Decedent's properties (the "Easthampton home") at no cost for five years after his death. Prior to his death, Decedent became estranged from his wife and acquainted with other women to whom he made large payments (the record is unclear on the nature of these relationships). Decedent also made payments to various family members, which the Estate argued were compensation for care and companionship services. The payments were not reported as gifts and Decedent did not issue a Form 1099-MISC, Miscellaneous Income, to the recipients.

Decedent died and his estate plan did not contain the bequests for wife's children or permit wife to reside at the Easthampton home, as required in the prenuptial agreement, as amended. Wife and wife's children brought claims against the Estate seeking enforcement of the prenuptial agreement. These claims were settled, and the Estate made the required payments. The estate tax return did not report the payments made prior to Decedent's death as gifts and took deductions to reduce the value of Decedent's gross estate by the value of wife's five-year right to reside in Decedent's real property and the payments to wife's children.

With respect to the transfers made prior to Decedent's death, the Tax Court held that the payments were gifts and not compensation for services rendered. The Tax Court reasoned that the checks did not indicate that they were compensation and Decedent did not issue Forms 1099 or W-2, Wage and Tax Statement, and did no report them on his personal income tax returns.

The Tax Court disallowed the Estate's deductions for payments of $1 million to wife's children and the value of wife's five-year right to reside in the Easthampton home. Code Section 2053 requires a deductible claim to be for "adequate and full consideration in money or money's worth." Code Section 2043(b) provides that a relinquishment of a dower or curtesy right, or of other marital rights in the decedent's property or estate, shall not be considered consideration in money or money's worth. Although the Estate argued these payments were made in exchange for the waiver of wife's spousal support rights, which falls outside the scope of Code Section 2043(b), the Tax Court pointed to the terms of the prenuptial agreement which specifically provided that the payments were in exchange for wife's marital inheritance rights.

b) ***Estate of MacElhenny v. Commissioner, T.C. Memo 2023-33 (March 15, 2023).***

Estate of MacElhenny v. Commissioner addressed whether an Estate could deduct the value of two consent judgments entered against Decedent and whether the decedent's children received taxable gifts by purchasing property from Decedent at a discount.

When Decedent became unable to manage his affairs, his son ("Son") took over and discovered two short-term debts, one debt owed to Union Bank and one debt owed to Westamerica Bank, that needed to be addressed immediately.

Union Bank Debt

Decedent was unable to make the upcoming payment owed to Union Bank. Son and Union Bank settled the debt and agreed Son would pay Union Bank $2,650,000 in his individual capacity and in exchange the remainder of the judgment and Union Bank's interest in secured properties would be assigned to Son and Daughter. By a separate agreement between Son and Daughter, Daughter obtained at 50% interest in the judgment. State Court entered an order substituting Son and Daughter as plaintiffs for the judgment against Decedent for $6,000,000 at 10% annual interest.

Westamerica Debt

Decedent's wholly owned entity defaulted on its debt owed to Westamerica. The parties settled the matter by stipulating a judgment and requiring the sale of one of Decedent's properties. Even after such sale, Decedent could not pay the judgment and Son purchased the judgment pursuant to a settlement agreement. State Court entered a judgment which provided Son with a judgment of $865,517 accruing 10% interest.

The El Mercado Property

Decedent's Revocable Trust transferred a 50% in the El Mercado Property to each of Son and Daughter for $4,750,000. Pursuant to the purchase agreement, Son and Daughter assumed the $1,614,391 mortgage and received a credit of $3,135,609 for the remainder. The credit

comprised the $2,650,000 paid to acquire the Union Bank judgment and a $485,609 offset against the Union Bank judgment.

Decedent didn't file a gift tax return. After Decedent's death, the estate tax return claimed a $3,638,083 deduction attributable to the remaining value of the Union Bank judgment and a $1,007,320 deduction attributable to the Westamerica judgment.

The IRS argued the debts were not bona fide debts and therefore not deductible from the Estate under Section 2053. Son and Daughter argued that the debts were bona fide because the State Court entered judgments.

The Tax Court agreed with the IRS and reasoned that once Son and Daughter settled the debts, Decedent was no longer personally obligated to make payments, and the assignments did not change the result, given that the assignments were made neither in the ordinary course of business nor at arm's length since Son was on both sides of the transaction and the assignments had donative motivation.

In addition, the Tax Court held that since the Union Bank claim was not a bona fide liability, the reduction in debt was not consideration in money or money's worth in the sale of the El Mercado Property. Therefore, the Tax Court held that Son and Daughter received a gift upon receiving the El Mercado Property.

7) Estate of Hoensheid v. Commissioner, T.C. Memo 2023-34 (March 15, 2023).

In *Estate of Hoensheid*, the tax court considered whether a taxpayer had unreported capital gain income due to his right to proceeds from the sale of shares which he had previously gifted to a donor-advised fund, and whether he was entitled to a charitable contribution deduction for such donation.

Scott Hoensheid and his two brothers were the sole shareholders of Commercial Steel Treating Corp. ("CSTC"), a company started by their grandfather. In the fall of 2014, one brother informed the other two that he wanted to resign from the company. The remaining brothers did not want to incur debt in order to buy the retiring brother out, so they all agreed to sell.

CSTC engaged FINNEA Group ("FINNEA"), an investment banking firm, as its financial adviser in connection with a sale of CSTC. In early 2015 FINNEA began soliciting bids for CSTC and received several letters of intent to purchase the company from interested private equity firms. HCI Equity Partners (HCI), a private equity firm, submitted a letter of intent on April 11, 2015 to acquire CSTC for total consideration of $92 million.

Meanwhile, in mid-April 2015, petitioner began discussing the prospect of establishing a donor-advised fund ("the DAF") to make a presale charitable contribution of some of his CSTC stock. On April 16, 2015, petitioner's attorney emailed one of her partners, who also served as CSTC's corporate counsel, and mentioned that petitioner was considering donating some of his CSTC stock to charity "to avoid some capital gains" and noted that "the transfer would have to take place before there is a definitive agreement in place."

Soon thereafter, petitioner responded in an email to his attorney, as follows:

> *Anne and I have agreed that we want to put 3.5MM in the fund, but I would rather wait as long as possible to pull the trigger. If we do it and the sale does not go through, I guess my brothers could own more stock than I and I am not sure if it can be reversed. I have not definitively given [advisor] a number. Please know this and help us plan accordingly.*

On April 23, the companies executed a nonbinding letter of intent for HCI's acquisition of CSTC for $107 million.

On June 1, 2015, petitioner emailed his estate attorney requesting that she prepare a shareholder consent agreement allowing him to transfer a portion of his stock to the DAF. In the email, petitioner reiterated to his attorney that "I do not want to transfer the stock until we are 99% sure we are closing."

On June 11, 2015, CSTC shareholders approved the sale to HCI. The brothers also approved petitioner's request to be able to transfer a portion of his stock to the DAF and executed a Consent to Assignment agreement to that effect. The Consent to Assignment agreement had a blank space for the parties to specify the number of shares and stated that the consent governed "only the number of shares identified above." However, that field was left blank and not filled in on June 11, when the parties signed the agreement, nor on June 15, 2015, when petitioner emailed a copy of the signed agreement to his attorney.

At some point after June 11, 2015 petitioner had a stock certificate partially prepared for the eventual transfer to the DAF. Petitioner kept the incomplete stock certificate on his office desk until July 9 or 10, when he dropped it off at his attorney's office. An electronic copy of the stock certificate was not delivered to the DAF until July 13.

On June 12, 2015, HCI approved the acquisition of CSTC, subject to completion of their financial and business due diligence.

On July 1, HCI's counsel prepared a revised draft of the Contribution and Stock Purchase Agreement. This draft, dated July 1, 2015, included a new, partially blank recital (share contribution provision) stating in relevant part: "On June 2015, [Petitioner] transferred … shares of Common Stock to ….." HCI also prepared and circulated the initial draft of the Minority Stock Purchase Agreement for a purchase of shares from the DAF.

On July 6, petitioner emailed his advisors and sent them the draft Minority Stock Purchase Agreement and stating: "We are not totally sure of the shares being transferred to the charitable fund yet" and "[h]opefully, and based on the closing documents, we will have a much better handle on this come Wednesday or Thursday of this week." Petitioner added: "Once we know the share values, I am confident [attorney] will execute the stock assignment as required." On July 9, 2015, CSTC prepared a revised draft of the Contribution and Stock Purchase Agreement. In this revised draft, counsel for CSTC had partially filled in the recital relating to the gift transfer to read in relevant part: "On July … 2015, [petitioner] transferred 1,380 shares of Common Stock to [the DAF]."

On July 10, CSTC paid out employee bonuses totaling $6,102,862 pursuant to its newly amended Change in Control Bonus Plan, and submitted an amendment to its Articles of Incorporation, which had been requested by HCI.

On July 15, HCI, CSTC, petitioner, and his two brothers executed signatures on a final Contribution and Stock Purchase Agreement, which was approved by CSTC's shareholders and board that same day. The final agreement included the share contribution provision, which specified that petitioner had transferred 1,380 shares to the DAF on "July 10, 2015." The Stock Purchase Agreement provided that HCI would purchase the 1,380 shares from the DAF. The DAF received $2,941,966 in cash proceeds from the sale, which was deposited into petitioners' giving account.

On November 18, 2015, the DAF sent petitioners a contribution confirmation letter acknowledging a charitable contribution of 1,380.400 shares of CSTC stock. The letter indicated that the DAF received the shares on June 11, 2015,

Petitioner's estate attorney prepared and timely filed petitioner's federal income tax return. Petitioner did not report any capital gains associated with the sale of the 1,380 shares and claimed a noncash charitable contribution deduction of $3,282,511.

Petitioner attached to his return a Form 8283, reporting a contribution of $3,282,511 relating to the 1,380 shares of CSTC stock and a date of contribution of June 11, 2015. The declaration of appraiser section on the Form 8283 was signed by Brian Dragon as appraiser, and the donee acknowledgment section was signed by a representative of the DAF. Attached to the Form 8283 was a document entitled "CSTC Fidelity Gift Fund Valuation," which purported to be a qualified appraisal that Mr. Dragon prepared with respect to the "CSTC Fidelity Gift Fund." According to the appraisal, Mr. Dragon determined that the 1,380 shares of CSTC stock had a value of $3,282,511 as of June 11, 2015, which was $340,545 higher than the actual proceeds the DAF received from the sale of those shares. The appraisal included a brief biography of Mr. Dragon (which did not address whether he had appraisal experience or qualifications), a valuation summary, the Forms 8283 and 8282, Donee Information Return, and a number of transactional documents relating to the acquisition by HCI.

The appraisal report valued the CSTC stock as of June 11 but did not expressly disclose a date of contribution for the shares. The appraisal included a page that listed a number of traditional valuation approaches and quoted from a section of Rev. Rul. 59-60, that discusses valuation of securities. On the following page the appraisal stated that FINNEA "elected not to contemplate the aforementioned traditional valuation methods in favor of the empirical valuation resulting from its thorough marketing efforts below." The appraisal did not further explain the empirical method used in the appraisal. Neither did it include a statement that it was prepared for federal income tax purposes.

Mr. Dragon had previously performed valuations on a limited basis, including one estate tax valuation, but had not previously prepared an appraisal substantiating a charitable contribution of shares in a closely held corporation. He did not charge an additional fee for the appraisal in addition to what he and FINNEA had already received as fees in the transaction with

HCI; nor did he and petitioner execute a separate engagement letter for him to perform the appraisal.

On October 9, 2019, the IRS issued a notice of deficiency, resulting from petitioner's failure to report the sales proceeds attributable to the contributed shares and the disallowance of the claimed charitable contribution deduction.

Anticipatory Assignment of Income

The Court first addressed whether the petitioner should have included the sales proceeds attributable to the DAF's shares in his gross income. The court noted that gross income means "all income from whatever source derived," including "[g]ains derived from dealings in property." However, a taxpayer will generally not recognize gain when disposing of appreciated property via gift or charitable contribution. Therefore, contributions of appreciated property are tax advantaged compared to cash contributions, because a taxpayer can both avoid paying tax on the unrealized gains and deduct the property's fair market value.

The Court then noted that there is a two-part test to determine whether to respect the form of a charitable contribution of appreciated property followed by a sale by the donee. The donor must (1) give the appreciated property away absolutely and divest of title; (2) before the property gives rise to income by way of a sale.

The Court looked to state law to evaluate the first prong of the test, and noted that Michigan law requires a showing of (1) donor intent to make a gift; (2) actual or constructive delivery of the subject matter of the gift; and (3) donee acceptance.

Petitioner and the IRS each argued different dates for when petitioner made the gift to the DAF. Petitioner argued that a gift was made on June 11, 2015. The IRS argued that a valid gift was not made until at least July 13, 2015, when the DAF first received the stock certificate.

The Court examined the three elements of a completed gift, in turn.

a) ***Present Intent***

The Court acknowledged that a donor's intent is an inherently fact-based inquiry and turned to the facts of the case. June 1, petitioner first expressed in an email that he wanted to wait to make the gift of the shares to the DAF until the last possible moment, when he was "99% sure" that the sale to HCI would close. Petitioner's subsequent actions and communications were consistent with that intent. The executed Consent to Assignment Agreement did not state the number of shares to be donated. Similarly, the original stock certificate failed to specify an effective date. On July 6, petitioner stated in an email that he was still "not totally sure of the shares being transferred to the charitable fund yet."

Petitioner testified that he believed the number of shares to be donated was set at 1,380 on June 11, but the court concluded this was self-serving testimony and gave it no weight. The court concluded that July 9 was the date petitioner had the present intent to make a gift.

b) ***Delivery***

The Court then turned to the delivery requirement, noting that it requires an "open and visible change of possession" of the donated property. The donee must have dominion and control over the property and it must be "beyond the power of recall by the donor."

The Court noted the completed stock certificate remained on petitioner's desk until July 9 or 10 and was only delivered to the DAF on July 13. The Court concluded delivery did not occur until July 13.

c) ***Acceptance***

Based on the fact recited above, the Court concluded the DAF could not have accepted the shares before July 13.

Right to Income

Having determined the date of the gift, the Court turned to whether petitioner had a fixed right to income from the shares. The Court examined several factors, including (1) any legal obligation to sell by the donee; (2) the actions already taken by the parties to effect the transaction; and (3) the status of the corporate formalities required to finalize the transaction.

a) ***DAF's Obligation to Sell***

The Court concluded the IRS had not shown the existence of any informal, prearranged understanding between petitioners and the DAF regulate the sale. The DAF was under no legal obligation to do so.

b) ***Actions Taken by Parties - Bonuses & Shareholder Distributions***

The Court looked at the acts CSTC and HCI took to finalize the sale before the July 13 gift. As of that date, HCI had caused the incorporation of a new holding company subsidiary to acquire the CSTC shares; CSTC had amended its Articles of Incorporation as requested by HCI, and CSTC paid out approximately $6.1 million in employee bonuses and $4.7 million to the shareholders.

c) ***Corporate Formalities***

Finally, the Court looked to the status of the corporate formalities necessary for effecting the transaction, noting that the petitioner and his brothers approved the sale on June 11 and that all three were involved in negotiating the sale; by July 13, the sale was almost certain to occur and petitioners right to income from the sale of CSTC shares was thus fixed as of the gift on July 13, 2015. We hold that petitioners recognized gain on the sale of the 1,380 appreciated shares of CSTC stock.

Charitable Contribution Deduction

Even though the Court concluded the transfer was an assignment of income, the petitioner still could have received a charitable contribution deduction for the gift to the DAF.

Section 170(f)(11)(A)(i) provides that a taxpayer must attach a qualified appraisal, prepared by a qualified appraiser, to his return for all contributions in excess of $500,000.

The Regulations require that a qualified appraisal include:

> (1) "[a] description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was (or will be) contributed;"
>
> (2) "[t]he date (or expected date) of contribution to the donee;"
>
> (3) "[t]he name, address, and … identifying number of the qualified appraiser;"
>
> (4) "[t]he qualifications of the qualified appraiser;"
>
> (5) "a statement that the appraisal was prepared for income tax purposes;"
>
> (6) "[t]he date (or dates) on which the property was appraised;"
>
> (7) "[t]he appraised fair market value … of the property on the date (or expected date) of contribution;" and
>
> (8) the method of and specific basis for the valuation.

The statute provides that a "qualified appraiser" is an individual who

> (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations,
>
> (2) regularly performs appraisals for which the individual receives compensation, and
>
> (3) meets such other requirements as may be prescribed … in regulations or other guidance.

An appraiser must also demonstrate "verifiable education and experience in valuing the type of property subject to the appraisal." The regulations add that the appraiser must include in the appraisal summary a declaration that he or she (1) "either holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis;" (2) is "qualified to make appraisals of the type of property being valued;" (3) is not an excluded person specified in paragraph (c)(5)(iv) of the regulation; and (4) understands the consequences of a "false or fraudulent overstatement" of the property's value.

The IRS argued that petitioner's appraisal was not a qualified appraisal because it (1) did not include the statement that it was prepared for federal income tax purposes; (2) included

the incorrect date of June 11 as the date of contribution; (3) included a premature date of appraisal; (4) did not sufficiently describe the method for the valuation; (5) was not signed by Mr. Dragon or anyone from FINNEA; (6) did not include Mr. Dragon's qualifications as an appraiser; (7) did not describe the property in sufficient detail; and (8) did not include an explanation of the specific basis for the valuation.

The Court agreed and held that the appraisal was deficient with respect to several key substantive requirements. First, the appraiser was not qualified.

The Court also found that the appraisal was substantively deficient in stating an incorrect date of contribution. Accordingly, the Court denied the deduction.

8) Charitable Deduction Substantiation

a. Bass v. Commissioner, T.C. Memo 2023-41 (Mar. 27, 2023).

In this case, the tax court denied certain charitable contribution deductions taken by the Petitioner.

During 2017 petitioner donated clothing and various nonclothing items to Goodwill and the Salvation Army. He made 173 separate trips to Goodwill and the Salvation Army, often making multiple trips on the same day to avoid in his view the need to have the items appraised. For each trip, a Goodwill or Salvation Army worker provided him with a donation acknowledgment receipt, which he in turn filled out, listing the items donated and their fair market values. Petitioner's Goodwill receipts showed donated items totaling $18,837, and his Salvation Army receipts showed donated items totaling $11,779.

On his return petitioner reported, among other items not relevant here, gifts to charity totaling $18,999, consisting of noncash charitable gifts and “carryover” charitable gifts. The details of his noncash charitable gifts were shown on three Forms 8283. One Form 8283 was for gifts to Goodwill, another was for gifts to the Salvation Army, and a third was for gifts to a third charity. Each Form 8283 stated that petitioner had donated “VARIOUS” property in “Good used” condition having an “[a]ppraised fair market value” of $10,286, which he had purchased in January 2017 for $4,360.

Petitioner did not attach any appraisals to the 2017 return. Not surprisingly, the Service denied the charitable contribution deduction.

Relying on the fact that he made 173 separate trips to Goodwill and the Salvation Army and received a donation acknowledgment receipt for each trip, petitioner testified that because the donated items reflected on each receipt had a fair market value of less than $250, he did not need to have any of the items appraised. The Court disagreed, noting that for purposes of determining the $5,000 threshold, and accordingly whether the “appraisal” requirements are applicable, the Regulations mandate aggregating similar items of property donated to one or more charitable organizations. Because he had not obtained an appraisal he was not entitled to a deduction.

b. Braen v. Commissioner, T.C. Memo 2023-85 (Jul. 11, 2023

Petitioners were members of the Braen family who owned a mining company, Braen Commercial Holdings Corp. ("Holdings"). In 1998, Holdings purchased roughly 500 acres of land in a small town in New York, believing the land had significant deposits of granite and other minerals.

Prior to the purchase of the land, the family began the process of petitioning the town to amend its zoning law to permit quarrying in the area. Over the next eight years, Holdings attempted to effectuate a change in the zoning law, but to no avail. In fact, in 2004, the town passed a new comprehensive zoning law that would have completely barred Holdings planned activities. In 2005, Holdings filed a lawsuit opposing the zoning change.

In settlement of that lawsuit, Holdings and the town agreed that the town would purchase 425 acres of the property for $5.25 million and would reverse its restrictive zoning decision as to the remaining 80 acres. The agreement between the parties stated that they were aware that the transfer by Holdings was being undertaken as a bargain sale, and the purchase agreement specifically stated that the zoning lawsuit was being settled as party of the sale from Holdings to the town. The sale of the property closed in 2010.

To prepare its 2010 return, Holdings' CPAs submitted a request to the IRS for a prefiling agreement. In gathering the information for this agreement, the CPAs realized that Holdings had not sought nor obtained a contemporaneous written acknowledgment from the town. Holdings' attorney sent a statement to the town for signature. The town responded with a revised statement making clear that the purchase was part of the settlement of a lawsuit.

Holdings filed its 2010 S corp return and claimed a charitable contribution deduction of $5,222,000 arising out of the bargain sale, and included a Form 8283, which described the donated land and referred to attached appraisals showing the value at $10,72,000. None of appraisals included the settlement agreement that concluded the zoning litigation or the purchase agreement. The Service disallowed the charitable contribution deduction.

The Court noted that resolution of the parties' dispute hinged on two principal requirements to claim a charitable contribution deduction in connection with a bargain sale. Those requirements are: (1) the fair market value of the property donated must exceed the value of any benefits received; and (2) the taxpayer must supply a contemporaneous written acknowledgment from the recipient substantiating the contribution.

In addressing the first prong, the court held that the taxpayer did not provide a value for consideration received in the bargain sale, therefore was not entitled to a charitable contribution deduction. The purchase agreement and the settlement of the lawsuit were an "inseparable package." In negotiating the settlement, Holdings made clear that it wanted a reversal of the zoning decision, as least as to a portion of the property. Therefore the negotiated reversal was consideration to Holdings that was required to be reported.

Holdings argued that it was entitled to the reversal as a matter of law (i.e. it would have prevailed in the lawsuit) and therefore, the town's decision was of no value. The Court

disagreed with this argument, and held that even if Holdings was certain to prevail, in settling the suit, it avoided protracted and costly litigation.

The Court went on to note that even if it held that the reversal of the zoning requirement was not valuable consideration to Holdings which should have been reported on its income tax return, it would still not be entitled to the charitable contribution deduction because of its failure to obtain a contemporaneous written acknowledgment from the town. Section 170(f)(8) of the Code requires that the contemporaneous written acknowledgment state (1) the amount of cash and a description of any property other than cash contributed, (2) whether the charitable organization provided any goods or services in consideration, in whole or part, for the contributed property, and (3) a description and good-faith estimate of the value of any goods or services the taxpayer received as consideration. The acknowledgment received from the town was required to describe the value received by Holdings and provide a good-faith estimate of it. It did neither, and therefore did not meet the criteria for a contemporaneous written acknowledgment.

c. **Tucker v. Commissioner, T.C. Memo 2023-87, (Jul. 17, 2023**

The Petitioner was a software engineer, turned want-to-be fashion maven. She created a sole proprietorship named "Camarbre" in 2010, and by 2012 was operating the entity full-time. She marketed Camarbre as a "fashion lifestyle brand"; in fact, she likened the company to a fashion house, like Ralph Lauren.

In 2017, Petitioner decided to support a local church that was struggling financially. She proposed a fashion show. Petition paid all expenses, including models, makeup, hairstylists and food. She paid these expenses in cash or by credit card. The church charged the public to attend the fashion show and kept all of the proceeds.

Before the fashion show took place, the church sent two unsigned documents to the Petitioner. Both indicated amounts paid by Petitioner for the fashion show, but neither contained a statement regarding any goods or services that may have been received in exchange for such payments.

On Petitioner's income tax return, she deducted $25,000 for cash charitable gifts to the church.

The Court denied the deduction because the Petitioner did not properly substantiate the amounts paid. The Court noted that all documents received from the church were "woefully inadequate" because they failed to indicate whether she received any goods or services in exchange for her donation.

9) Estate of Block v. Commissioner, T.C. Memo 2023-30 (Mar. 13, 2023)

Ms. Susan Block died on October 21, 2015. She had previously executed a Revocable Trust Agreement, and Article 4 of that agreement provided for a subtrust, the Katz Trust, to be funded upon Ms. Block's death. The Katz Trust existed for the benefit of Ms. Block's sister and her sister's husband. The property remaining in the Katz Trust was to be distributed to a charitable foundation.

Article 4.1 of the Trust instrument stated that Ms. Block intended the Katz Trust to be "a charitable remainder annuity trust, within the meaning of Rev. Proc. 2003-57 and §664(d)(1) of the Code, and the terms of this Section shall be construed to give maximum effect to such intent." Article 4.1(A) directed that an "annuity amount" be paid to Ms. Block's sister during her life (or to her spouse if he survived her), in an amount "equal to the greater of: (a) all net income, or (b) the sum of Fifty Thousand Dollars ($50,000), at least annually."

The trust agreement also provided that "the Trustee shall have the power, acting alone, to amend [the trust] from time to time in any manner required for the sole purpose of ensuring that [the trust] qualifies and continues to qualify as a charitable remainder annuity trust within the meaning of §664(d)(1) of the Code. The Trustee may not, however, change the annuity period, the annuity amount, or the identity of the Recipient [of the annuity amount]."

After the Service initiated an examination of the Estate's Form 706 in August 2017, the co-trustees executed an amendment to the Trust instrument (First Amendment) with an effective date of October 21, 2015, (Ms. Block's date of death). The First Amendment's stated purpose was to revise Article 4.1(A) to provide that the trustees shall pay from the Katz Trust "an annuity amount equal to the sum of Fifty Thousand Dollars ($50,000), at least annually." The First Amendment removed "all net income" from the determination of the "annuity amount."

The Court held that despite this amendment, the trust failed to qualify as a charitable remainder annuity trust (CRAT). A CRAT as a trust with the following four characteristics:

A. "[A] sum certain (which is not less than 5 percent nor more than 50 percent of the initial fair market value of all property placed in trust) is to be paid, not less often than annually," to the income beneficiaries, at least one of which is not a charitable organization. In the case of individual beneficiaries, the annuity may last for either a set period of years (not to exceed 20) or the individual's remaining lifetime.

B. No payments other than the annuity may be made to the noncharitable beneficiaries.

C. At the end of the annuity period, the entire remainder is to be transferred to one or more charitable organizations.

D. The present value of the remainder interest, determined at the time of the trust's funding, is at least 10% of the initial fair market value of the trust assets.

A "sum certain" is defined to mean "a stated dollar amount which is the same either as to each recipient or as to the total amount payable for each year of [the annuity] period."

If a trust initially fails to qualify as a CRAT, the taxpayer still may take a charitable deduction if there is a "qualified reformation" of the trust. A qualified reformation cannot occur unless the remainder interest is a "reformable interest", meaning that in the pre-reform trust (1) the remainder interest is exclusively charitable and (2) all payments to the noncharitable beneficiaries are "expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property." There is an exception to the "specified dollar or fixed percentage" requirement: An initially nonfixed interest will be excused if, within 90 days after the due date for the estate tax

return, a judicial proceeding is commenced that results in the trust qualifying as a CRAT, retroactive to the date of the decedent's death. If that happens, the remainder is deemed a reformable interest.

Article 4.1(A) of the Trust instrument, as it originally read, directed the trustees to pay to the income beneficiaries an "annuity amount equal to the greater of: (a) all net income, or (b) the sum of Fifty Thousand Dollars ($50,000), at least annually." The provision was not limited to a specific stated dollar amount and therefore violated the requirement that the annuity of a CRAT be a "sum certain." Consequently, the court held that the trust did not qualify as a CRAT at the time of Ms. Block's death.

The Estate argued that the First Amendment to the Trust instrument effected a qualified reformation. However, the Court noted this was not possible as the original trust did not contain a reformable interest. Therefore the only other possibility was a judicial reformation. However, that too was no use as the First Amendment was executed far beyond the 90-day period following the due date for the estate tax return). Second, the amendment was instituted by the co-trustees alone, not approved by a court in a judicial proceeding.

10) Estate of Cecil v. Commissioner. T.C. Memo 2023-24 (Feb. 28, 2023).

Petitioners, Mr. and Mrs. William A.V. Cecil, Sr., asked the Court to reverser the Service's determination of a $13,022,552 gift tax deficiency for the 2010 tax year. In November of that year, Mr. Cecil transferred nonvoting shares in the Biltmore Company ("TBC") to trusts for their five grandchildren and Mrs. Cecil transferred voting shares to trusts for their two children.

TBC was formed in 1932, by Mr. Cecil's mother, Cornelia Cecil. Cornelia was the only child of George Vanderbilt. TBC owns the Biltmore Estate[63] in Asheville North Carolina and much of the surrounding acreage.

TBC operates primarily in the travel and historic hospitality industry. Not only does it offer tours of the house itself, but has expanded into a multiday destination which includes hotels, restaurants, retail stores, and various outdoor activities. During 2010 TBC operated at least 17 lines of business and employed 1,304 employees (over 1,800 combined full-time and part-time employees including associated businesses).

Mr. and Mrs. Cecil elected to split gifts and timely filed their gift tax returns. Each return included as an attachment an appraisal of the gifts based on a weighted average of the subject shares (using an asset approach and an income approach).

The Service selected the Cecil's returns for audit, and ultimately issued notices of deficiency. The notices of deficiency disregarded the existence of TBC and attributed no weight to its going-concern value. The adjustments in the notices of deficiency reflected the enterprise value of TBC based solely on an asset liquidation assumption.

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[63] Biltmore Estate is the largest privately-owned home in the United States, consisting of over four acres of floor space.

The Court begins by giving a good overview of the approaches, used to determine the fair market value of property: (1) the market approach, (2) the income approach, and (3) the asset-based approach.

The market approach compares the subject property with similar property sold in an arm's-length transaction in the same timeframe. This approach values the subject property by taking into account the sale price of the comparable property and the differences between the comparable property and the subject property.

The income approach capitalizes income and discounts cashflow. This approach values property by computing the present value of the estimated future cashflow as to that property. The estimated cashflow is ascertained by taking the sum of the present value of the available cashflow and the present value of the residual value.

The asset-based approach generally values property by determining the cost to reproduce it. One example of an asset-based approach in the setting of a nonpublicly traded corporation is to value the corporation on the basis of the fair market value of its net assets (i.e., the fair market value of its assets less its liabilities).

At trial, the Cecils produced two appraisal experts (neither of whom performed the appraisal attached to the original return) and the Service produced one. All three of the experts agreed that tax affecting had to be considered in determining the fair market value of the gifted shares. The Court summed up the theory behind tax affecting explaining that, "the data used to value an S corporation are largely based on the data from C corporations, proponents of tax affecting believe that the mismatch from pretax cashflows and after-tax discount rates must be adjusted through tax affecting to ascertain the fair market value of the S corporation."

In *Gross v. Commissioner*, the Tax Court rejected the application of tax affecting, concluding that

> the principal benefit that shareholders expect from an S corporation election is a reduction in the total tax burden imposed on the enterprise. The owners expect to save money, and we see no reason why that savings ought to be ignored as a matter of course in valuing the S corporation.

However, in *Estate of Jones*, the Tax Court concluded that tax affecting was appropriate. There, the parties agreed that a hypothetical buyer and seller would take into account the entity's business form when determining the value of a limited partner interest; they simply disagreed on how to account for it.

Most recently, in *Estate of Jackson v. Commissioner*, the Tax Court did not find tax affecting appropriate. There, estate's experts and the Service's experts disagreed on whether tax affecting was appropriate. The court in *Jackson* distinguished *Jones* by noting in that case, the experts agreed. In *Jackson,* the estate's experts had not persuaded the Court that tax affecting should apply.

In *Cecil*, experts on both sides agreed that tax affecting was necessary to value the shares; therefore, the Court accepted its application. However, it noted that "while we are applying tax affecting here, given the unique setting at hand, we are not necessarily holding that tax affecting is always, or even more often than not, a proper consideration for valuing an S corporation."

11) US v. Paulson, 68 F. 4th 528 (9th Cir. 2023)

Allen Paulson, founder of Gulfstream Aerospace, died on July 19, 2010, with an estate worth roughly $200 million. He was survived by his third wife, three sons from a prior marriage and several grandchildren. Nearly all of Mr. Paulson's $200 million in assets was in titled in the name of his revocable trust at his death. One of his sons was Executor and co-Trustee of the trust. In October, 2021, the executor filed the estate's Form 706 which reported a total gross estate of almost $188 million, a net taxable estate of $9.2 million , and an estate tax liability of approximately $4.5 million. The estate paid a portion of the tax liability with the return and elected to defer the remaining balance under IRC § 6166.

The Service audited the estate tax return and in 2005 ultimately determined the estate owed an additional $6.7 million in taxes. Again, the estate elected to defer the payment of the taxes under IRC §6166.

During this time, the co-Trustees of the Paulson revocable trust transferred assets to Paulson's wife and at least $7.2 million to the other beneficiaries.

In 2009, Paulson's son was removed as trustee of the living trust for misconduct and appointed two other beneficiaries were appointed as co-trustees. The IRS argued that at that time the trust contained assets worth more than $13.7 million, which exceeded the estate tax liability. Two beneficiaries claimed the living trust was insolvent, with $10.8 million in assets, but $28.3 million in liabilities, including $9.6 million in federal tax liability.

In 2010, the IRS terminated the §6166 election because the estate missed an installment payment. In 2011, one of the co-Trustees was removed and two new ones appointed. The Service argued that at that time, the revocable trust held assets worth at least $8.8 million. In 2013 the family members resolved their various disputes, but the revocable trust was depleted by then.

In 2015, the US filed an action against the beneficiaries in their individual and representative capacities. The government sought a judgement against the estate and the trust for balance of the estate tax liability, which exceeded $10 million and judgements against the individuals under §6324,

Section 6324 protects the government's ability to collect transfer taxes. The statute imposes a lien on the decedent's gross estate for the unpaid estate taxes and imposes personal liability for such taxes on those who receive or have estate. The provision at issues in this case was §6324(a)(2) which provides that:

> If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employees' trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the

property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of decedent's death, of such property, shall be personally liable for such tax

The Court framed the issue before it as whether the phrase "on the date of the decedent's death" modifies only the immediately preceding verb "has," or if it also modifies the more remote verb, "receives." The government argued the limiting phrase "on the date of decedent's death" modifies only the immediately preceding verb "has," and not the more remote verb "receives." Therefore, in its view, the statute imposed personal liability on those listed in the statute who (1) receive estate property at any time on or after the date of the decedent's death, or (2) have estate property on the date of the decedent's death.

The defendants argued that the limiting phrase "on the date of the decedent's death" modified both the immediately preceding verb "has," and the more remote verb "receives." Under this interpretation, the statute imposed personal liability for the unpaid estate taxes only on those who receive or have property included in the gross estate on the date of the decedent's death. Those who receive property from the estate at any point after the date of the decedent's death have no personal liability for the unpaid estate taxes.

After a lengthy discussion of judicial cannons of construction, the Court held that the rule of the last antecedent should apply. This cannon provides that "a limiting clause or phrase . . . should ordinarily be read as modifying only the noun or phrase that it immediately follows. Therefore, it agreed with the government that the phrase "as of decedent's date of death" modified only the verb "has." This is the first case to adopt this interpretation. In another first, the Court also held that the term "beneficiary" included trust beneficiaries.

The ultimate holding was that the successor trustee had personal liability for unpaid taxes and two beneficiaries who received trust assets years after the decedent's death were also liable.

12) Estate of Kalikow v. Commissioner, T.C. Memo 2023-21 (Feb. 27, 2023).

In *Estate of Kalikow v. Commissioner*, the tax court examined whether the value of QTIP trust assets included in the gross estate should be reduced by an agreed-upon payment of undistributed income and whether the undistributed income payment was deductible under Code Section 2053.

Decedent was predeceased by her husband. Decedent's husband's estate planning documents provided for the creation of a QTIP trust for the benefit of decedent. The husband's estate made the appropriate QTIP election during the administration of his estate. The QTIP trust was funded with a 98.5% limited partnership interest in Kalikow Family Partnership, L.P. and $835,000 of cash and marketable securities. The QTIP trust was required to terminate upon

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Decedent's death and the remaining assets were distributed to continuing trusts for the benefit of Decedent's two children.

Upon her death, Decedent's will provided that her residuary estate would be distributed to Sunshine Foundation, a charitable organization that Decedent established.

Litigation ensued after Decedent's death regarding the payment of income from the QTIP trust during Decedent's lifetime with the plaintiffs claiming that insufficient income was distributed during the administration of the QTIP trust. After litigating the matter for a decade, the parties reached a settlement that the QTIP would pay out $9,200.000, which included $6,572,310 in undistributed income along with other amounts for commissions, accounting fees and legal fees.

After the filing of the estate tax returns, the IRS issued a notice of deficiency. The parties settled most of the issues prior to the hearing on the cross summary judgment motions. The only remaining issues for decision and that were the subject of the summary judgment motions were (i) whether the value of the QTIP trust's assets included in Decedent's estate under Code Section 2044 should be reduced by the undistributed income amount to be paid under the settlement agreement and (ii) whether the various components under the settlement agreement payment were deductible under Code Section 2053.

Code Section 2044 generally includes the full fair market value of QTIP trust property in the gross estate of the beneficiary-surviving spouse. Prior to the hearing, the parties agreed on the value of the limited partnership interest. The tax court provided that having stipulated as to the value of that interest, the administrators could not then argue for a lesser value as a result of the undistributed income payment liability. Further, the settlement agreement provided that the payment of the settlement amount was the joint and several liability of the QTIP trust and the two continuing trusts for the benefit of Decedent's children—which would allow the QTIP trust to make a claim against the two other trusts for the satisfaction of the liability. The liability was not a liability of the partnership interest and therefore could not impact the value of that interest. The tax court held that the inclusion of the full fair market value of the QTIP trust was appropriate under Code Section 2044 and that it should not be offset by the value of the undistributed income payment.

Code Section 2053(a) allows a deduction for certain amounts, including administration expenses and claims against the estate. The tax court held that the parties incorrectly focused on the limitations of claims under Code Section 2053(a) but disregarded the fact that the settlement payment was not an obligation of the estate but instead an obligation in favor of the estate. The obligation of the QTIP trust is not an obligation of the estate and therefore cannot be deducted—in fact, the obligation of the QTIP trust is an asset to be included in the gross estate. Accordingly, the tax court did not allow the deduction.

13) *Schlapfer v. Commissioner*, T.C. Memo. 2023-65 (May 22, 2023).

In 2006, Ronald Schlapfer purchased a life insurance policy (the "Policy") with $50,000 cash and all of the stock from his solely owned closely-held entity (referred to herein as "EMG"). That same year, Mr. Schlapfer attempted at various times to transfer the Policy to his

mother, aunt and uncle, though the change in ownership was not likely completed until 2007 (the "Gift"). In 2013, Mr. Schlapfer, who was born in Switzerland, entered the IRS Offshore Voluntary Disclosure Program ("OVDP") in order to resolve any income tax liabilities associated with his offshore accounts. He submitted a disclosure packet to the OVDP on November 20, 2013. In his disclosure packet he provided a gift tax return for 2006 and other tax documents, including a protective filing for the gift tax return (claiming that he was not subject to gift tax liability in 2006, because he did not intend to reside permanently in the United States until he became a U.S. citizen in 2008) and financial statements for EMG, a Panamanian corporation. On the filed 2006 gift tax return and in other documents included in the disclosure packet, he described the Gift as a transfer of his EMG stock to his mother instead of as a transfer of the Policy to his mother, aunt and uncle.

Upon reviewing the disclosure packet, the IRS ultimately issued a deficiency notice on October 17, 2019, based on its determination that the gift of the Policy was made in 2007, not in 2006, and that Mr. Schlapfer had failed to file a 2007 gift tax return. Mr. Schlapfer challenged the determination, arguing that he had adequately disclosed the gift on his 2006 gift tax return and that the IRS's assessment period had already expired.

Code Section 6501(c)(9) and Treas. Reg. Section 301.6501(c)-1(f)(1) provide that ordinarily the IRS only has three years to assess a gift that has been adequately disclosed on a filed gift tax return or a statement attached to it. The idea is that an adequately disclosed gift provides the IRS with enough information to decide whether it should audit a transaction. Treas. Reg. Section 301.6501(c)-1(f)(2) lists the information to report in order to adequately disclose a gift, including, relevant to Mr. Schlapfer's gift, (i) a description of the gifted property, (ii) the identity of the transferee and (iii) a description of the method used to determine the fair market value of the gifted property.

The Tax Court held that Mr. Schlapfer adequately disclosed his gift of the Policy on his 2006 gift tax return, and that by 2019 the IRS was time barred from assessing the gift. In its reasoning, the Tax Court discussed several features of adequate disclosure for gift tax purposes. First, the Tax Court held, based on Treas. Reg. Section 301.6501(c)-1(f)(5), that it matters when a gift is reported but it does not matter if that gift is later deemed to be incomplete. The Commissioner argued that there was no adequate disclosure since Mr. Schlapfer filed a 2006 gift tax return for a transfer made in 2007. The Tax Court rejected this argument, finding that for adequate disclosure purposes Mr. Schlapfer started the limitation period by reporting his gift on a 2006 gift tax return, regardless of when he completed the gift. The reporting gave the IRS notice of a gift. Second, the Tax Court held that information outside of a gift tax return, and especially statements reported with a gift tax return, can be considered for adequate disclosure purposes. As a result, the Tax Court reviewed several documents included in Mr. Schlapfer's disclosure packet, in addition to the 2006 gift tax return, in order to determine if the IRS had sufficient notice to make an audit decision. Third, the Tax Court rejected the Commissioner's argument that Mr. Schlapfer had to strictly comply with the adequate disclosure requirements and instead adopted a more lenient substantial compliance standard. The Tax Court found that Mr. Schlapfer did not strictly comply with the adequate disclosure requirements: (i) neither his gift tax return nor any of the considered documents identified the Policy as the gifted property; (ii) his submissions to the IRS mentioned his mother but did not mention his aunt and uncle as

transferees; and (iii) none of his documents described his method for determining the fair market value of either the Policy or the EMG stock. However, the Tax Court found that he did substantially comply those requirements: (i) since the value of the Policy derives from the EMG stock, the disclosure of the stock transfer was sufficient to notify the IRS of the nature of the actual gift of the Policy; (ii) the identification of his mother as a transferee provided the IRS enough information to know that the nature of the transfer was a gift to the transferor's family member, even if he failed to identify his aunt and uncle; and (iii) because the value of the Policy primarily derived from the value of the EMG stock used to purchase it, all of the EMG financial statements filed in the disclosure packet was sufficient to inform the Service of the method for determining the value of the Policy.

14) Planning Techniques.

This section discusses planning techniques available to clients who are interested in transitioning wealth to the next generation and taking advantage of higher exemption rates while they are available.

a) ***Basic Planning***. Although this likely goes without saying, advisers should ensure that clients have engaged in basic estate planning, including the execution of proper testamentary documents and powers of attorney. It is not uncommon for a client to approach an initial meeting ready to dive into complex estate planning strategies even though the client has not initially taken steps to complete basic planning. Just as important as ensuring basic planning has been completed is the need to ensure that the testamentary plan is updated after any lifetime strategies are implemented. If a client opts to create a generation-skipping trust during lifetime and allocate generation-skipping tax exemption to that trust, then the testamentary plan should likely be updated to take this into account (and can often be simplified to incorporate these trusts created during lifetime into the testamentary documents rather than using newly created trusts under those documents).

b) ***Basic Elements of Lifetime Strategies***. Advisers should keep in mind the following underpinnings of lifetime strategies to ensure that they are as effective as possible:

i) ***Utilize Discounts***. Where possible, transfer interests in property or business interests that will be eligible for minority, lack of control and/or lack of marketability discounts. Together, these discounts can, in certain circumstances, exceed 20% or more of the appraised value of transferred property. For example, if a business is worth $25 million and the client wishes to fund a lifetime trust with business interests, the client could transfer 49% of the ownership of the company to the trust and, with appropriate discounts, report a gift of under $10 million even though it effectively removes $12.25 million from the client's estate.

ii) ***Transfer Appreciating Property***. Where possible, clients should transfer appreciating property when making lifetime gifts. Transferring appreciating assets not only removes the current value of the assets from the client's estate, it also removes the future appreciation attributable to the gifted asset(s) from the client's estate. For instance, if a client owns an asset that is projected to appreciate 50% over the client's remaining lifetime and it is currently worth $20,000,000, then a gift of that asset today will remove not just $20,000,000 from the

client's estate, but an additional $10,000,000 that could not have been gifted without incurring gift tax. Combine this with discounts, and the client is able to transfer even more value at a lower cost.

iii) ***Utilize Grantor Trusts***. Code Sections 671 through 679 treat grantors of trusts as the owners of the trusts under certain circumstances. The tax result is that the grantor includes all tax items associated with the trust on the grantor's tax return. Grantor trust status can be incredibly beneficial for the following primary reasons: (i) the payment of income tax on a trust's income is a gift tax free gift that enables the trust to continue growing without the burden of income tax; (ii) the tax payments will further reduce the grantor's estate; and (iii) grantor trust status enables future planning techniques, such as sales to the grantor trust, without adverse tax consequences because for tax purposes the grantor and the trust are the same taxpayer. Common methods of achieving grantor trust status include, among others, the retention of the non-fiduciary right to reacquire assets of equivalent value, the right of the Trustee to pay premiums on life insurance using the income of the trust and the power to lend trust assets to the grantor without adequate security.

iv) ***Formula Clauses***. Where clients are attempting to transfer a specific dollar amount like the client's remaining lifetime exemption of a hard to value asset (e.g., an interest in a closely-held business entity), advisers and clients should consider the use of a formula clause when making the gift. As advisers are well aware, gifts of this nature are subject to audit by the IRS and an audit can result in a drastically different valuation than the valuation obtained by the client in an appraisal. If an audit results in an increased valuation and the client transferred a specific number of shares or a specific percentage interest in the closely-held entity, then the finally determined value of that interest will result in a larger gift which could result in the imposition of gift tax. A formula clause, such as a *Wandry*[64] clause, phrases a transfer in the terms of value. For instance, a *Wandry* clause transfers that percentage of the donor's membership interest that has a value equal to $12,090,000 on the effective date of the transfer. When a clause of this nature exists, an increased valuation of the underlying company does not change the value of the gift because the total value of the gift is capped. Instead, the percentage interest transferred is decreased and that change is noted on the books of the company. These clauses provide great upside protection for assets that are subject to significantly different valuations. For clients who are charitably inclined, approved formula clauses exist that would transfer any excess over a certain defined amount to a charitable entity.[65]

c) ***Outright Gifts***. If a client is not concerned with generation-skipping planning or retaining some level of control or direction over an asset or is simply one of those clients who abhor complicated estate planning strategies, then the client may elect to simply make outright gifts of property to family members. Large outright gifts may be appropriate in some instances and discounts can still be used for these types of gifts. Many clients, however, will opt to utilize trusts for planning to be able to control how those assets benefit family members in the future and to protect the assets from creditors of beneficiaries (including spouses of beneficiaries) and to

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[64] *See Estate of Wandry v. Comm'r*, T.C. Memo 2018-88 (March 26, 2012).
[65] *See Christiansen v. Comm'r*, 586 F.3d 1061 (8th Cir. 2009), and *Estate of Petter v. Comm'r*, 598 F.3d 1191 (9th Cir. 2011).

provide a legacy that will last for multiple generations (rather than being squandered by a descendant during his or her lifetime).

d) ***Spousal Lifetime Access Trusts***. Spousal Lifetime Access Trusts ("SLATs") have become incredibly popular over the past decade. They were often utilized in 2012 when individuals intended to utilize their remaining lifetime exemption amount with the scheduled decrease of the estate tax exemption the following year. SLATs are described below.

i) ***Description***. A SLAT is an irrevocable trust created by one spouse (the "donor-spouse") for the benefit of the other spouse (the "beneficiary-spouse") and other beneficiaries the donor-spouse identifies, if any. Although a SLAT's structure can vary depending on client preference, a SLAT generally grants the Trustee discretion to distribute income and principal for the benefit of the beneficiary-spouse and any other named beneficiaries. The SLAT can also be restricted to only benefit the beneficiary-spouse during his or her lifetime or to emphasize that the beneficiary-spouse is to be considered the primary beneficiary of the SLAT.

ii) ***Benefits***. SLATs offer the following benefits:

(1) A SLAT may be used to take advantage of high gift tax exemptions before they expire under current law, while allowing the beneficiary-spouse to continue to use and enjoy the assets irrevocably gifted by the donor-spouse.

(2) A SLAT removes appreciation on the contributed assets from the donor-spouse's estate.

(3) A SLAT offers protection from the beneficiary-spouse's creditors.

(4) A SLAT is a "Grantor Trust" for income tax purposes, which results in all income being taxed to the donor-spouse, provides the benefits described above and will enable the donor-spouse to engage in transactions with the SLAT at a later time, if desired.

iii) ***Risks***. Risks with SLATs are as follows:

(1) ***Reciprocal Trust Doctrine***. If each spouse creates a SLAT for the other and the SLATs are too similar, the IRS could utilize the reciprocal trust doctrine to unwind the transaction such that it is treated as if each spouse created a trust for his or her own benefit, which would cause estate tax inclusion of the trust assets. Some methods of differentiating SLATs are as follows:

(a) Create and fund the trusts at separate times;

(b) Utilize different trustee appointments (e.g., name an independent third party as the trustee of one trust or utilize Co-Trustees for one trust);

(c) Incorporate a power of appointment in one trust but not the other; or

(d) Utilize different beneficiaries for each trust (e.g., name the spouse and issue as beneficiaries of one trust and just the spouse as the beneficiary of the other trust).

The more differences that are created between the trusts, the more likely it would be to withstand IRS scrutiny. Unfortunately, there is not significant case law in this area, so no strategy can be guaranteed protection from IRS scrutiny.

(2) ***Divorce***. One question clients usually ask is, "What happens if we get divorced?" That is certainly a risk. If a SLAT is created for a spouse and then the couple subsequently divorces, unless appropriate provisions are included in the trust agreement, the ex-spouse will continue to benefit from the SLAT. One option is to provide that the SLAT will terminate as to the beneficiary-spouse and be divided among issue upon the earlier of the beneficiary-spouse's death or a divorce or separation.

iv) ***Example***. Donor-spouse transfers $12,920,000 in marketable securities to a new SLAT for the benefit of beneficiary-spouse. Assuming the SLAT has a 7% growth rate, after 15 years the value of the SLAT (not taking into account distributions) will have grown to $35,646,688, which represents $22,726,688 in appreciation and an estate tax savings of $9,090,675 (at the current 40% tax rate).[66]

e) ***Generation-Skipping Trusts***. If a client has sufficient wealth and the client is not concerned with maintaining access to a gift (as with a SLAT), then the client may be more interested in implementing a trust plan that provides for descendants via a generation-skipping transfer tax exempt dynasty trust. This strategy is briefly described below.

i) ***Description***. A trust of this nature may initially provide for a "pot trust" that benefits the client's children until all of the children attain a certain age or some other predefined event (e.g., the decision of an individual to terminate the "pot trust" or the death of the client). Upon termination of the "pot trust," the assets are usually divided into separate generation-skipping trusts for the children and their issue. Each child's trust will terminate upon the child's death and be divided into separate generation-skipping trusts for each of the child's children. This division will continue in perpetuity (for a jurisdiction that has abolished the rule against perpetuities) or until the assets are diminished or the Trustee opts to distribute all of the assets outright.

ii) ***Benefits***. Generation-skipping trusts offer the following benefits:

(1) The client utilizes the client's remaining estate, gift and generation-skipping transfer tax exemptions.

(2) If the trust is structured as a grantor trust, it will continue to grow income-tax free and can be utilized for more advanced planning techniques in the future.

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[66] Note that this calculation ignores distributions made from the trust and any taxes paid by the trust during the fifteen-year period.

(3) Because the assets will remain in trust for each successive generation, the assets will be sheltered from transfer taxes at the transition of each generation. This will enable the trust assets to avoid tax rates as high as 40% or more that would likely be incurred if the assets were owned by beneficiaries outright.

(4) The trust assets may be sheltered from the claims of the beneficiaries' creditors.

iii) ***Risks***. Assuming that the trust is properly drafted to avoid retained powers by the client that could result in estate tax inclusion, this strategy is fairly benign. Aside from the risk of a retroactive tax law, the major risk would be the risk of a valuation adjustment if the gift tax return is audited. That risk, however, can be mitigated with an appropriate formula clause.

f) ***GRATs***. GRATs offer a great opportunity for clients to transfer appreciation on assets outside of the client's estate.

i) ***Description***. A GRAT is an estate freeze technique that allows a client to "freeze" the value of assets in the client's estate while transferring assets to the next generation at a reduced transfer tax cost. With a GRAT, the client retains an annuity interest in the property transferred to the trust during the term of the GRAT (often a short-term period of two years). The annuity amount, which is customarily defined as a percentage of the initial funding value of the GRAT plus a minimum rate of return based on the Code Section 7520 Rate, is paid to the client each year. Any assets remaining at the end of the GRAT's term will be distributed to the remainder beneficiaries. GRATs can be used in conjunction with other trusts such that the remainder is distributed to another trust. Alternatively, continuing trusts can be created under the GRAT. GRATs are most effective when the Code Section 7520 Rate is low, as it currently is, because the annuity amount that must be paid to the client is based on the Code Section 7520 Rate. The lower the required annuity is, the greater the remainder interest will be and the more successful the GRAT will be.

ii) ***Benefits.*** GRATs offer the following benefits:

(1) A GRAT can be structured to reduce a gift to zero (or close to zero) which does not reduce the client's lifetime exemption.

(2) A GRAT freezes the value of assets in the client's estate by removing appreciation attributable to the contributed assets.

(3) Appreciation passes gift-tax free to remainder beneficiaries.

(4) GRATs are "Grantor Trusts" for income tax purposes, which results in all income being taxed to the client, which provides the benefits described above.

iii) ***Risk***. If the GRAT underperforms (does not beat the Code Section 7520 Rate) or if the client dies during the term, all of the assets contributed to the GRAT will be included in the client's estate—the same result as if the GRAT had not been created.

iv) ***Additional GRAT Strategies***. The traditional GRAT strategy can be amplified with the following strategies:

(1) ***Rolling GRATs***. The client may choose to roll each annuity received into a new GRAT each year, which is often identical to the original GRAT. Additional assets can be added to the annuity payment to reach a desired funding amount. This will ensure all appreciation associated with the assets continue to be transferred out of the client's estate.

(2) ***GRATs by Asset Class or Type***. Whether a GRAT is successful entirely depends on the return generated by the assets within the GRAT. Many clients seek to optimize the performance of GRATs by creating multiple GRATs with each GRAT holding a specific asset class or type. The rationale is that if one asset type underperforms, it will not negatively affect a GRAT that would otherwise perform well based on the other assets. If a GRAT underperforms, there simply will not be any assets remaining for the distribution to the remainder beneficiaries after payment of the required annuity.

v) ***Example***. Client transfers $3,000,000 in marketable securities to a new GRAT in February 2023 when the 7520 Rate is 4.6%. The GRAT has a two-year term and an assumed 7% growth rate. The GRAT results in a taxable gift of $0.01, an annual annuity payment to the donor of $1,604,278.07, and a tax-free distribution of $113,844.40 to the remainder beneficiaries.

g) ***Sale to an Intentionally Defective Grantor Trust***. A sale to an intentionally defective grantor trust (an "IDGT") is another strategy that is not intended to utilize remaining lifetime exemption and, therefore, is a strategy that may be considered by a client who is concerned about the risk of retroactive tax legislation. A description of this strategy is included below.

i) ***Description***. A sale to an IDGT is an estate freeze technique that allows a client to transfer an asset's future appreciation to the next generation with no transfer tax cost. This strategy requires the creation of the IDGT by the client, a "seed" gift67 by the client to fund the IDGT, and a subsequent sale of an asset to the IDGT by the client. The IDGT is typically structured to benefit the client's spouse and/or the client's descendants. Because the IDGT is a "Grantor trust," the client may engage in transactions with the IDGT without income tax consequences. After creation and funding of the IDGT, the client sells an asset to the IDGT for fair market value in exchange for a promissory note with interest payable to the client at the AFR. Typically, the asset sold to the IDGT (often an interest in an LLC or partnership) receives discounts for lack of marketability and lack of control. In addition, it is customary for the promissory note to require interest-only payments with a balloon payment of principal at the end of the term. If the asset is sold at a discount, and the asset generates a rate of return while owned by the IDGT that is greater than the interest rate charged on the promissory note, the client is able to transfer wealth to the IDGT free of gift tax. The IDGT is designed to avoid estate inclusion for the client. With the AFR rate at a historic low, having a return that is greater than the interest rate is simpler than it has been in the past.

ii) ***Benefits***. The benefits for a sale to an IDGT are as follows:

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[67] The "seed" gift is, generally, 10% of the value of the asset to be sold to the IDGT.

(1) A sale to an IDGT freezes the value of assets in the client's estate by transferring the assets to the IDGT in exchange for a promissory note of equivalent face value. Appreciation on the sole asset passes gift-tax free to the trust beneficiaries.

(2) IDGTs are "Grantor trusts" for income tax purposes, which provides the benefits described above.

(3) A client's generation-skipping transfer tax exemption may be allocated to the IDGT upon funding to maximize future transfer tax benefits of the IDGT.

(4) The interest payments made by the IDGT to the client are not taxable income to the client because the payments are technically being made from the client, as the IDGT for tax purposes, and to the client, individually.

iii) ***Risk***. If the client dies during the term of the note, the outstanding value of the promissory note will be included in the grantor's estate.

iv) ***Example***. Client sells a membership interest in an LLC valued at $1,000,000 to an IDGT in exchange for a promissory note requiring interest-only annual payments using the mid-term AFR of 0.58%. The promissory note has a nine-year term and the membership interest sold to the IDGT has an assumed 5.0% rate of return each year. At the end of the term, the membership interest has grown to a value of $1,487,374.14 as compared to the $1,000,000 debt the IDGT must repay to the client. This appreciation avoids approximately $194,949.66 in gift tax (assuming the current 40% tax rate) and removes the membership interest's future income and appreciation from the client's estate.

h) ***Intra-Family Loans***. In this low-rate environment, intra-family loans are a great tool to give family members the benefit of a client's wealth at little-to-no cost. Note that this strategy is not intended to utilize lifetime exemption. A brief description is included below.

i) ***Description***. An intra-family loan may be considered an estate freeze technique that allows a client (the lender) to "freeze" the value of assets in the lender's estate while transferring assets to the next generation at no transfer tax cost. The IRS-approved interest rate used for intra-family loans is the AFR. The IRS assigns AFRs based on the term of the loan: short-term (less than three years), mid-term (between three and nine years) and long-term (longer than nine years). Intra-family loans can be used by the borrower for any purpose, including to purchase a home, start a business, or otherwise invest. When the borrower earns a rate of return in excess of the AFR, the loan has a similar effect as a transfer of wealth from the lender to the borrower but without gift tax consequences. Note that an alternative strategy of refinancing existing intra-family loans using today's low AFRs can reduce the cost of capital for a related borrower and minimize income taxable to the lender.

An intra-family loan is documented using a promissory note that can be structured to require interest-only payments with a balloon principal payment at the end of the term, or amortized with traditional installment payments of principal and interest. Collateral is not required but may be recommended depending on the circumstances.

ii) ***Benefits***. Benefits of intra-family loans are as follows:

(1) The borrower obtains a low-interest loan and pays interest to a family member, as opposed to a commercial lender.

(2) If the borrower obtains a rate of return higher than the interest rate charged, wealth transfer benefits occur without transfer taxes.

(3) The lender may be able to forgive a portion of the loan each year using the lender's gift tax annual exclusion ($15,000) or lifetime exemption ($11,700,000 million).

iii) ***Risk***. The loan must be documented properly and administered according to its terms. Otherwise, the loan may be deemed a gift and taxed accordingly.

iv) ***Example***. Parent makes a $1,000,000 interest-only loan to a child for a term of eight years using the 0.52% AFR. The child invests the loan proceeds in securities and obtains a 5% rate of return each year during the loan term. At the end of eight years, the parent has received interest income of $41,400, the child has earned $436,055 in net appreciation, and the parent has avoided gift tax on the net appreciation of approximately $174,422.